Box 15

OVERVIEW OF THE FINANCIAL MARKET INFRASTRUCTURE

The European financial market infrastructure – which is composed of payment systems, securities clearing and settlement systems and payment instruments – is in the middle of a development process. The pace of the creation of an internal market for financial services in the various financial market infrastructure components has been uneven, and the provision of services to an ever-larger number of international market participants and markets poses increasing challenges. Over the longer term, the efficiency of the EU-wide infrastructure must be enhanced, and the efficiency of EU financial markets must be promoted in many ways. Improving the efficiency and integration of payment systems and financial systems more generally are important objectives of the ECB. When the infrastructure operates reliably, it fosters financial stability as well. This Box provides an overview of the most important infrastructural developments.

Payment systems

TARGET and EURO1 are still the most crucial payment systems within the euro area in terms of number and value of payments handled, and the bulk of large-value payments continue to be concentrated in these systems. TARGET is used for processing intra-Member State and inter-Member State interbank and customer payments. In 2005, the daily average number of payments processed by the system as a whole was almost 300,000, representing a value of €1.9 trillion. TARGET's operational reliability has improved continuously since its launch, and its availability rate[1] was 99.89% in the first half of 2006. EURO1 is the most important privately owned and EU-wide operated payment system for large-value payments, and its turnover figures have been steadily increasing. In 2005 the average number of transactions stood at close to 160,000 payments per day with a total value of €166.7 billion. As well as offering EURO1 for large-value payments, EBA CLEARING offers STEP2 arrangements for the processing of small-value payments in euro. The smooth functioning of STEP arrangements depends on the EURO1 system, through which settlement is made.

The CLS system is an FX settlement system aimed at reducing banks' risks in the settlement of foreign exchange trades. It achieves this by applying a strict risk management regime and by settling trades on a PVP basis in its own books. The number of transactions settled through it has risen significantly, and by late 2006 CLS was settling on average over 200,000 payment instructions each day with an average gross value of more than USD 2 trillion. The euro is the second most settled currency in the system after the US dollar, with a settlement value of 20% of all FX trades. The smooth functioning of the CLS system ultimately depends on continuous operation of the TARGET system and on the corresponding RTGS systems of all the currencies handled in it.

The authorities support market integration by several means. The European Commission has, for example, prepared a new legal framework for payments in the internal market to harmonise EU legislation. In addition, the Eurosystem actively supports banks' efforts to create a Single Euro Payments Area, or SEPA, which should be well advanced by the end of 2010. The common payment instruments included in the initiative are credit transfers, direct debits and card

1 This is the ratio of the time when TARGET is fully operational to the total TARGET opening time.

payments. The use of modern technology promotes the efficiency of the entire payment system. In parallel, the Eurosystem has continued its work towards developing a new large-value payment system, with the second generation of TARGET, TARGET2, planned to be launched in the second half of 2007. According to the implementation schedule, TARGET users will migrate to TARGET2 in different waves on different predefined dates starting on 19 November 2007.

Securities clearing and settlement systems

The introduction of the euro has accelerated the existing process of consolidation in securities market infrastructures. This process has continued both in terms of the integration of systems and ownership arrangements. However, although progress has been made with stock exchange integration, the integration of post-trade processes has been slower, and the operating field is still fairly fragmented. The consolidation of regional stock exchanges into increasingly larger entities is important from the point of view of enhancing their competitiveness. In addition to traditional stock exchanges, several alternative trading systems such as new electronic communication networks (ECNs) have been introduced in the euro area, offering similar functionality and services to traditional exchanges.

Integration via ownership arrangements is a more difficult process in which progress is much slower. As a result of the consolidation process, the number of euro area central counterparties halved from 14 to seven in the period from January 1999 to May 2006; the number of central securities depositories (CSDs), by contrast, diminished by only five, from 23 to 18. However, it should be noted that most CSDs operate as parts of holding companies (i.e., the Euroclear Group, Clearstream International, the Bolsas y Mercados Españoles (BME) group in Spain, etc.). So far the number of CSDs has only slightly fallen, but efficiency gains have been sought by developing common systems and concentrating operations. In this respect, achieving straight-through processing (STP) and system interoperability (e.g. through the application of common standards) are the key challenges to be addressed in both national and international markets.

A recent example of consolidation was the Letter of Intent regarding the acquisition of Eignarhaldsfelagid Verdbrefathing hf (EV) signed by the OMX[2] and EV, the owner of the Iceland Stock Exchange (ICEX) and the Iceland Securities Depository.[3] With the EV joining the OMX Group, OMX now comprises the exchanges of Stockholm, Helsinki, and Copenhagen, Iceland and partly of Tallinn (62%), Riga (93%) and Vilnius (93%), as well as the CSDs of the Baltic countries and Iceland.

In addition to the consolidation process, two different solutions have emerged in response to demands from securities market participants to rationalise the securities settlement industry: cross-border links, and the relayed links solution. Concerning the first of these solutions, links between the securities settlement systems (SSSs) have been established to facilitate cross-border transfers of securities. To be eligible for use in the Eurosystem's credit operations, the links are assessed according to the Eurosystem's standards.[4] The relayed links solution allows two SSSs to transfer securities through an account with one SSS acting as an intermediary.[5]

2 An exchange operator and technology provider in the Nordic and Baltic region.
3 The Letter of Intent was signed on 19 September 2006.
4 EMI (1998), *Standards for the Use of EU Securities Settlement Systems in ESCB Credit Operations*.
5 In January 2005, the ECB's Governing Council decided that relayed links between SSSs may be used for the cross-border transfer of securities to the Eurosystem.

Relayed links are however only eligible after an assessment has been carried out to ensure that certain conditions have been met. At the beginning of 2006, a total of 59 links were eligible. So far, however, the use of links has been more modest than expected, with the correspondent central banking model (CCBM) currently being used more widely than the links between SSSs. The CCBM was established to facilitate the cross-border use of collateral in the Eurosystem's monetary policy operations and intraday credit operations. As no comprehensive market alternative to the CCBM service has yet emerged, which was designed as an interim arrangement in the absence of a market solution throughout the euro area, the ECB has begun to analyse possible paths for the evolution of the operational framework for collateral management in the Eurosystem. Turning to the second of these solutions, the implementation of new models such as relayed links could increase the use of links in the future. Some central counterparties (CCPs) have already established links amongst themselves, for instance between LCH.Clearnet SA and the Italian CCP CC&G.