

Vertical Integration and Regulation in the Securities Settlement Industry

Frédéric Cherbonnier (Toulouse School of Economics)

and

Jean-Charles Rochet (Toulouse School of Economics and IDEI)

In addition to the issues concerning the completion of an internal European financial market, the clearing and settlement industry may face a competition problem similar to that encountered in the telecom and transport sectors. For the regulator, the issue as a whole hinges on the need to allow for the achievement of economies of scale, while avoiding the possibility that an upstream monopolistic position might thwart competition in the downstream market, i.e. banking activities or securities trading activities. The objective of the present study is to address directly this issue, by analyzing the impact of regulations that may be enforced by a competition authority (such as non-discriminatory access pricing rule) or by a more intrusive regulating agencies (such as cost-based regulation). We consider a model in which custodians are competing with a central security deposit, where all net transactions must be in the end settled, in order to provide both custody and banking services. We show that the most effective regulatory intervention is to impose an access price to the CSD slightly higher than the marginal costs, in order to penalize custodians and improve the market share of the CSD, which is inherently more efficient.