

ISSA Regional Meeting Singapore

October 16-17, 2003

Hosted and chaired by Singapore Exchange (SGX)

1. Opening Remarks

Mr Ang Swee Tian, SGX President, welcomed 66 delegates, representing 35 ISSA member and guest institutions from 14 countries.

Mr Ang updated the audience of the latest development at SGX. Responding to a changing, more competitive environment, the exchange put in place a new organisational structure as of September 1, 2003. SGX pursues a strategy of complete integration of the securities and derivatives markets, on the level of trading as well as on the level of clearing and settlement. The new SGX is now structured according to functions and no longer by markets as in the past. The new structure will result in cost savings for the market participants. It will also allow SGX to respond better to the needs of its customers and partners, optimise the use of its own resources, and expand its revenue base by offering additional business lines.

The full text of Mr Ang's opening address is available separately.

2. ISSA Information Items

Mr Landolt's full presentation is available separately. Main points included:

- ISSA's participation in the 5th General Assembly of the Americas' Central Securities Depositories Association (ACSDA) in Cancun in March 2003. ISSA's contribution was threefold:
 - An initial assessment of the G30 recommendations and ISSA's plans for dealing with them.
 - An update on the current restructuring of the European capital market infrastructures following the introduction of the Euro.
 - A review of local, regional or global industry initiatives in the area of corporate actions and reference data standardisation, highlighting the multitude of parallel efforts and the need for coordination.
- A summary of the European ISSA meeting which took place in Madrid in May 2003. The consolidation of central market infrastructures, the blurring distinction between the ICSDs, local CSDs and custodian agent banks, the emergence of trade netting and of central counter parties in the cash markets in Europe, and new regulatory challenges, were the central aspects.
- ISSA's positioning towards the new G30 recommendations. Based on an analysis of overlaps and gaps between the ISSA Recommendations 2000 and G30, and on feedback obtained from the European members in Madrid, ISSA has offered

to the Group of Thirty to take monitoring responsibility for some of the G30 recommendations. At the same time, ISSA is willing to suspend monitoring activity on those ISSA Recommendations which are sufficiently reflected in equivalent G30 recommendations. ISSA's proposal is still preliminary, as it is subject to discussion with the Asia-Pacific membership, with other industry bodies that may become involved in the process, and with the G30 Monitoring Committee itself.

- The ISSA board has launched a review of ISSA's general direction and priorities for the next few years. In view of a possible close and long term involvement with the Group of Thirty monitoring process, the moment is right for a comprehensive analysis of questions relating to the allocation of resources, and alternatives to increase the efficiency in existing processes within ISSA. For this reason also, the Asia-Pacific regional chairmanship will remain vacant for the time being, following Wal Reisch's resignation in August.

3. Business Continuity Planning in the Wake of SARS and Terrorism

(SARS: Severe Acute Respiratory Syndrome)

The slides used by Mr Tan are available separately. Main points of his presentation included:

Prior to SARS and September 11, disaster scenarios in Singapore and many other markets generally assumed man-made, locally confined incidents, such as power outage, fire, chemical spill. The objects to protect were generally hardware items such as buildings and technology assets, or soft assets such as data, but not people. SARS and the implications of a massive terror attack proved many Business Continuity Planning (BCP) assumptions wrong or insufficient.

SARS and terrorism have certain common characteristics. Both deal devastating blows to business operations, can potentially cause loss of life of key executives and staff, will disrupt "conventional" crisis management plans, and may necessitate the use of alternative sites to be able to resume business operations.

There are different features as well: Terrorism usually leads to loss of physical assets and human life. SARS requires the segregation of staff to operate from decentralised locations. The spreading of SARS can be positively controlled - if not prevented - by taking rigid measures, whereas a terrorist attack is usually neither predictable nor controllable.

Mr Tan then recounted a chronology of events and measures taken in Singapore and at the SGX from the moment the first patients were hospitalised in the beginning of March, through May 31 when Singapore was removed from the World Health Organization list of SARS affected areas.

Lessons learnt included:

- Backup sites for shared use by multiple firms proved inadequate.

- Segregation of personnel was impeded by the lack of sufficient adequately trained staff to operate from decentralised locations, and by the lack of IT infrastructures.
- Increasing process automation and STP capabilities have expensive implications on BCP and disaster recovery solutions.
- The need for unmanned data centres, to be operated from a remote location, became obvious.
- There is a need to strengthen telecommuting (enabling key staff to work from home or even from a hospital).
- Prevention is a key element of a robust BCP strategy. Readiness is a means of protection.
- Always expect the unexpected!

The Monetary Authority of Singapore recently issued guidelines to financial institutions to strengthen business continuity preparedness. Financial institutions' BCP strategies will be reviewed as part of MAS' routine supervision of financial institutions, against the seven principles outlined below:

1. Board of Directors and senior management should be responsible for their institution's business continuity management.
2. Institutions should embed business continuity management into their business-as-usual operations, incorporating sound practices.
3. Institutions should test their business continuity plan regularly, completely and meaningfully.
4. Institutions should develop recovery strategies and set recovery time objectives (RTO) for critical business functions.
5. Institutions should understand and appropriately mitigate interdependency risk of critical business functions.
6. Institutions should plan for wide area disruption.
7. Institutions should practice a separation policy to mitigate concentration risk of critical business functions.

4. Demutualisation of Stock Exchanges

Mr Adachi shared the experience made by the Tokyo Stock Exchange (TSE) when going through the process of demutualisation. Founded in 1887, the TSE adopted its new structure on November 1, 2001. The slides used by Mr Adachi are available separately. Main points of his presentation included:

Demutualisation is a trend, but each case has its unique motivation, background and characteristics. The TSE made the decision to demutualise against the following background:

- Financial deregulation in Japan, particularly in three areas:
 - The change from a licensing system to a registration system for engaging in the securities business (December 1998) lowered entry barriers and thus increased the number of competitors.
 - The repeal of the "market concentration rule" (December 1998) encouraged off-exchange trading and intensified competition between the exchange and its members for order flow.
 - The abolition of the fixed brokerage commission system (October 1999) led to increased competition among exchange members which made it more difficult for the exchange to reach policy decisions by consensus.
- Transformation of the stock exchanges from traditional market places to electronic data processors, requiring substantial investment in IT infrastructures.
- Global trend to demutualise stock exchanges.
- A long term trend at the TSE evidencing a shifting investor profile, from domestic retail investors to institutional investors and growing capital inflows from foreign investors.

A number of concerns had to be overcome, voiced by the policy and lawmakers but also from the exchange members:

- Potential conflict of interest between the role of a self-regulatory organisation and a "for-profit" company.
- Potential impairment of the TSE's mandate to fulfil a service in the interest of the public at large.
- Loss of members' influence on exchange policy decisions.
- Dilution of members' interest in the value of the exchange.
- Corporate governance issues.

The concerns were addressed essentially by the TSE adopting a modernised organisational structure which introduced user-driven advisory committees and admitted investors, listed companies and academics to the board of directors.

Under the new structure, the TSE had to respond to a series of new challenges posed by a fully competitive environment:

- Need to find stable revenue sources, given that most exchange business is transaction based, market activity is unpredictable, and listing and similar fees cannot be raised indefinitely.
- Need for rigorous quality management and budget control.
- Need to recognise that a stock exchange cannot develop "bonanza products" like industrial companies. Product range and sales efforts have natural limits.
- Convincing shareholders that a long term business strategy must prevail over hunting short term profits.

Going public and listing the TSE on itself was found the most effective step to ensure that those challenges were addressed adequately.

Mr Adachi closed with the remark that today, only 8% of the investable household income in Japan flows into the securities market. Convincing the public to shift from saving its disposable income to investing it, remains a major task and entails a large growth potential for the TSE.

5. Third Party Clearing in Asia

The full presentation by Mr Brown is available separately. Main points included:

Third Party Clearing (TPC, also referred to as correspondent clearing in the Americas or general clearing member services in Europe) contributes to risk reduction, by concentrating clearing and settlement with financial institutions that are highly capitalised. It allows a larger number of market participants to operate as exchange members, thus achieving higher market liquidity.

TPC implies an arrangement whereby an exchange member transfers the obligation to clear and settle its trades to a third party, usually a custodian bank. That third party assumes the full legal obligation to complete the settlement process, even if the broker/dealer in question became insolvent in the time period between trade execution and settlement.

There are certain prerequisites for TPC: A legal and regulatory framework must be in place to enable and to legally bind a third party to settle a customer's trades as principal. Stock exchange rules must permit member firms to transfer their settlement obligation to a third party. In markets that operate with a central counterparty, that CCP will put in place eligibility criteria for financial institutions to act as third party clearers. The existence of a CCP is however not a prerequisite.

TPC brings advantages to all market intermediaries:

For the exchange:

- underpins market stability and financial integrity
- permits to broaden the exchange member base
- makes for a more liquid market

For the clearing house/CCP

- enables the CCP to increase minimum capital requirements for membership and thereby to lower its own exposure. Exchange members which do not meet the CCP's financial criteria can still participate in the market by using a third party clearer.

For broker/dealers and other exchange members

- provides a boost to operational efficiency
- staffing needs are decoupled from transaction volume fluctuation
- access to economies of scale
- swap of high fixed costs for variable costs
- access to better credit facilities and funding rates
- one stop access to multiple markets
- ability to focus on core business rather than trade processing

Mr Brown then gave an overview of the state of TPC in Asia and in other parts of the world. Refer to the full presentation for more details. In the Asia-Pacific region, TPC is possible in Australia, Indonesia, Japan, the Philippines, Singapore and Thailand, with Hong Kong joining the list soon. Each market has its local variation.

6. G30 and the ISSA Recommendations 2000 - Introduction to the Group Discussion Session

The slides used by Mr Stähli are available separately.

The presentation reviewed the main features and aims of the G30 recommendations. It highlighted the overlaps and gaps between G30 and the ISSA Recommendations 2000, and the resulting preliminary conclusions for ISSA.

The meeting participants were then invited to discuss in groups the relevance of the G30 recommendations to their firms or markets, identify their priorities, and offer their views as to what organisations are best suited to undertake appropriate action steps.

7. Working Group Presentations

Note: The composition of the three discussion groups was approximately equal in terms of geographic and provider type representation. Group 1 was asked to discuss recommendations 1-8 ("creating a strengthened, interoperable network"), Group 2 covered recommendations 9-16 ("mitigating risk"), and Group 3 addressed recommendations 17-20 ("improving governance").

Group 1

The participants in Group 1 identified (from the range allocated to the group) recommendations number 2 and 8 as the key priorities for ISSA.

Some statements from the group discussion:

Recommendation 1

The recommendation seeks to abolish all paper throughout the trade processing cycle. The group felt that the issue of dematerialising securities clearly belonged into the regulators' turf. All other areas with inherent potential for streamlining were closer to ISSA but not a key focus. The group assumed that the greatest efficiency gains could be made in the retail sector where ISSA is not directly involved. ISSA should not take on monitoring responsibility for the recommendation.

Recommendation 2

A key issue for the industry. The group debated whether "ownership" belonged to the business side, or to the technology side. Messaging standards allowing interoperability across market segments and country borders are vital to the business. ISSA should continue to promote common data and message formats. The group did not decide on monitoring ownership.

Recommendation 3

This recommendation is closely linked to number 2. Reference data like ISIN, place of listing and place of trading are vital. The group noted that developments like the "new Sedol" are not an ideal situation for the market. It was regretted that ANNA seems to have missed an opportunity to push for more standardisation, rather than to let individual solutions crop up again in the market. Number 3 is not a key priority for ISSA but surely important enough for ISSA to be involved. The group did not claim monitoring ownership for ISSA.

Recommendation 4

Follow-up on this recommendation was clearly assigned to the central banks.

Recommendation 5

The group regretted that, following the wind-up of GSTPA, the market is facing fragmentation, and the buy-side is struggling with high costs. Could Omgeo be the decisive factor? The group did not expect recommendation 5 to produce short term success on a global scale. ISSA should not take on monitoring responsibility.

Recommendation 6

Expanding the use of central counterparties was considered a laudable goal, but the group had no enthusiasm for monitoring by ISSA.

Recommendation 7

The group felt that ISSA should seek contact to global, regional or national (as appropriate) securities lending associations and coordinate monitoring activity.

Recommendation 8

Recommendation 8 was identified as a key recommendation for ISSA, particularly the area of corporate actions. Standardising corporate action terminology was singled out as the highest priority item. ISSA should focus on this field.

The group noted that investor protection issues are a logical turf for the regulators which are already heavily involved (for instance the U.S. SEC).

The group also felt that the harmonisation of tax documentation and procedures is an issue for the tax authorities to pursue, rather than for ISSA to spend substantial resources on.

Group 2

Group 2 assessed the recommendations on risk mitigation. Key points made:

Recommendation 9

Key issue is how to define a standard to measure a service provider's financial integrity. It was suggested to explore the feasibility of developing a standard along the ISO 900x approach. It was acknowledged that a lot of valuable work has already been completed by BIS/IOSCO. The group clearly felt that ISSA should not take on a monitoring role.

Recommendation 10

Recommendation 10 was considered closely related to number 9 and not discussed in detail. No monitoring task for ISSA. One participant noted that local regulators are already under instructions from BIS/IOSCO to monitor the risk management practices of financial services users, and to report regularly to BIS/IOSCO.

Recommendation 11

The discussion focused on the definition of DVP and how narrowly the term "simultaneous" should be interpreted. The group felt that a risk free trade settlement does not primarily depend on a simultaneous (however defined) exchange of value against countervalue. Various models are equally valid. However, the existence of three elements was considered crucial to achieve finality: Locked-in trade data, a settlement guarantee provided by a third party, and irrevocability. There was one voice championing a monitoring role for ISSA, due to finality being a fundamental market risk issue. If nothing else, the benefit would at least be a keen awareness of the risk status of each market. This vote was acknowledged but not widely supported by the rest of the group.

Recommendation 12

The recommendation was unanimously assigned to the regulators in each market to monitor. Importance was attached to the fact that each market should have cross-institutional business continuity plans in place, and also test them on a comprehensive basis. Clearly no monitoring role for ISSA.

Recommendation 13

Similar to number 12, the group clearly assigned activities and monitoring to the regulators. A question was raised whether central counterparties, where they exist, could monitor the financial standing of market participants, arguing that the CCPs have far reaching insight into their members' financial situation.

Recommendations 14, 15 and 16

The subject matters of those recommendations were considered outside of ISSA's core competence. No role to be assumed by ISSA.

To conclude the session, the members of Group 2 were invited to rank the eight recommendations by relevance, according to their personal or their home market's judgement. The winner of this non-representative poll was recommendation number 11, followed by numbers 9, 10, 13 (in that order).

Group 3

Group 3 established an order of relevance/priority for the recommendations dealing with governance issues. Key statements presented to the audience included:

Recommendation 17

The group discussed the term "seniority" and defined the most senior board member as the one having the broadest and deepest experience within the industry segment he/she is representing on the board in question.

The group also looked at how user owned and shareholder owned infrastructures differed in terms of qualifications required from their board members. A statement was made that monopolistic structures ought to be governed by their users. The group did not decide on monitoring ownership.

Recommendation 18

The discussion centred on the interpretation of the term "fair". When deciding whether an applicant should be given local or cross-border access to a central utility, risk aspects must prevail and "Know Your Customer" is of utmost importance. The group did not decide on monitoring ownership.

Recommendation 19

The group felt that this recommendation was written to protect smaller stakeholders against monopolistic abuse. Board members should recognise that they have a social responsibility towards smaller stakeholders who should enjoy equitable treatment. The group did not decide on monitoring ownership.

Recommendation 20

The group emphasised that "consistent" regulation and oversight does not mean "uniform" or "identical". Each market has its own specialities which need to be accommodated. Market by market assessments are required and justified, approach and standards/benchmarks etc. should however be aligned to the extent possible.

In deviation to the findings of the Madrid meeting, the group saw no meaningful role for ISSA in monitoring recommendation 20.

8. Concluding Remarks

Purpose of the meeting was to listen to experts' voices on topics the region itself had determined as the "hot" ones at this time. ISSA welcomed the opportunity to discuss the G30 recommendations with exponents from the Asia-Pacific region, completing the global picture.

Peter Chia and Josef Landolt thanked the participants for having contributed to the meeting. All delegates were encouraged to make their voices heard in their home market, while keeping the global perspective in mind. They were also invited to make use of opportunities to participate in cross-border discussions. Not taking part in a decision process means that decisions made by someone else must be accepted!
