

ISSA 11 Summary of the G30 Update

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G30 Steering Committee on Global Clearing and Settlement Systems

Background

The 1989 G30 Recommendations on Securities Clearance and Settlement focused on inadequacies in national securities processing systems. At that time, this was in line with market reality and market user demand. The cross-border aspect was neglected. The exponential growth in cross-border investing had not been anticipated to become so significant in such a short period of time. The legacy problem is now a cross-border environment that is expensive to cope with, that is fraught with inefficiency, and that is subject to a whole range of risks. There has been relatively little incentive, and a high degree of inertia, to sort things out. Exploiting inefficiencies in the existing processes is how some of us make our money, so the motivation on an individualised basis has not been high to move and eliminate such inefficiencies.

We are now entering a phase where we are creating an integrated environment. Securities trading, clearing, settlement, but also cash payment and Forex, are all being tied into an integrated network, both functionally and geographically. As that occurs, the vulnerability of the network and systemic risk therefore increases. Hence the rising interest of public authorities in systemic issues.

The new G30 Project

The new G30 Steering Committee is comprised of both public and private sector experts. In the Working Parties, all interest groups (users, intermediaries, service providers) are represented to ensure a thorough understanding of the issues and mechanics at work.

The focus of the project this time around is the cross-border arena, even though we will be pointing out to certain national issues.

The Steering Committee has to bear in mind that the final findings will have to reach a very diverse audience: they must appeal to decision makers at public policy level, to chairs and boards of financial institutions who influence their long term company strategy, but also to executives involved in the actual operations areas.

The project has been underway for 18 months already. This is due to the broad scope, and the complexity of the interests and issues involved.

We work towards two overall goals: firstly, to improve process efficiency, which is self explanatory and is mainly the concern of the private sector. Clearly, the questions of creating interoperability in its various ways are very well covered by the ISSA Recommendations 2000, and we are hoping to build out from those as we are looking ahead. Secondly, to improve systemic safety and stability which is of primary concern to the public sector. This includes the financial integrity of individual institutions, be they service providers or infrastructure users. It also includes the operational integrity of single institutions and entire securities systems. The September 11 events have clearly influenced this aspect and have added new concerns. There is heightened awareness of the need for workarounds if parts of a central system are out of action. There is also the question of how much safety we need and what contingency levels we can afford to maintain. Do we want double, triple safety layers?

The safety aspect also covers legal questions of finality, the integrity of the legal processes which the exchange of securities against countervalue creates in a cross-border context. Much of this relates to the territory covered by CPSS/IOSCO and we are seeking to build out from there.

Both delivery and implementation of the final recommendations is uppermost in our minds. How do we reach the intended audience? How to adopt standards once they are defined? Obviously, the first concern is the creation of standards. This is conceptually equivalent to creating the network in which we all operate. But of equal concern is realising the standards' potential i.e. their adoption.

It is important to acknowledge that today's world of who does what and who provides which function, is not set in stone. If efficiency gains are to be reached, the service scope provided by market players will and must evolve over time.

The G30 Philosophy

The new G30 recommendations follow a philosophy that aims at opening the market in ways that it can respond to public policy requirements; at removing barriers and then enabling the market forces to prevail, without trying to determine how largely the market forces should work. Ensuring openness of market access and choice of service provision from a user viewpoint are key considerations.

It follows that, if the market force is the preferred determining factor to bring about improvement, then it is upon the private sector to take action to move ahead. Board and management levels must be involved, of both service providers and service users. G30 will spell out a series of guidelines and recommendations the boards of directors should be mindful of, if the market is to move to something better than it is today. For instance, we will address duplicate capital expenditures, fairness towards different stakeholders etc. In other words, a charter for boards to follow for a network to be effective!

The private sector can deliver standards which are the enabling mechanism to interoperability and open networks. It can also agree on operational and legal conventions that create legal certainty and finality in a more predictable way.

But the public sector has to be involved as well, for it is upon the public sector to harmonise regulations to the extent possible, and to ensure fair competition by creating equal access rights to the market.

That said, we must note that we cannot wait for all the desirable and required changes in law to happen. Best practices must be adopted first. They can be a proxy for legal change and the law can catch up later. Experience shows that progress has always happened this way.

Consistency of Initiatives

There are encouraging signs that cooperation between the authors of various initiatives is increasing. Between ISSA and G30, we consider cooperation as a given. The latest European Commission document on the intended regulatory approach towards a more unified European financial market is encouraging as well. It largely matches what the G30 thinks. It is consistent with the Giovannini Report on which it builds.

There is global convergence as well: The BIS, the New York Fed, the European Central Bank are all represented on the G30 Steering Committee. This adds a lot of comfort and support for our chosen approach and facilitates cooperation to move things forward. Our work fits with the tenor of the CPSS/IOSCO recommendations. The G30 results are going to be consistent with them and will build on them.

Cost and funding

How much will such recommendation exercises and their implementation cost? These are frequent questions, especially in times of market decline and budget pressure! I must admit that I do not know the figures spent so far; nobody does. Nor do I know if the expenses are justified in the end. Nobody knows what the net cost equation will be, though we intuitively look for a lower unit cost. There will be costs of moving to new standards. The sooner one is asked to move to a new standard, the more expensive it is. However, if one is allowed to retain a standard until the life cycle of a given system software has reached its end anyway, then the marginal cost of building in changes is significantly less. A common sense approach is helpful.

The cost of moving, in certain cases, to improved networks and new or updated standards must then be put against the benefits of having the new system in place and being able to use it. There will be efficiency gains, lower backoffice costs and fewer providers of only partial services. Against this, there will be the running costs of maintaining the network - and in particular of risk mitigation. These are likely to rise as global networks get bigger and vulnerabilities increase.

Your feedback on the expected benefits of the exercise is invited!

Timing of the new G30 project

At this moment, the outline of our final report is completed. Extensive due diligence will be done during the summer months. Publication is planned for early autumn. Feedback from all interested parties before publication of the final report is always invited!

ISSA's role

Once the recommendations are published, the G30 itself seeks a minimalist but nonetheless coordinatory role only. Compliance monitoring has to be done by others. ISSA is clearly very well positioned to help with private sector monitoring. Public sector monitoring is to be dealt with separately, with the appropriate public authorities. Discussions with several possible organisations to take on that role are being held.

The G30 hopes to provide a useful umbrella for tying together the different initiatives. Hopefully this will create the momentum to bring about some real improvement in the crossborder arena as we move ahead.
