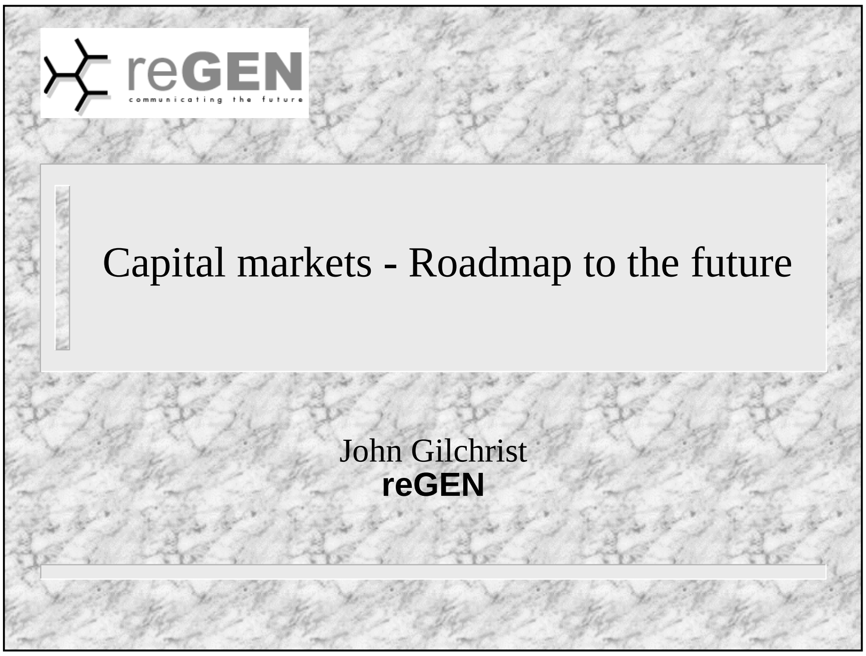
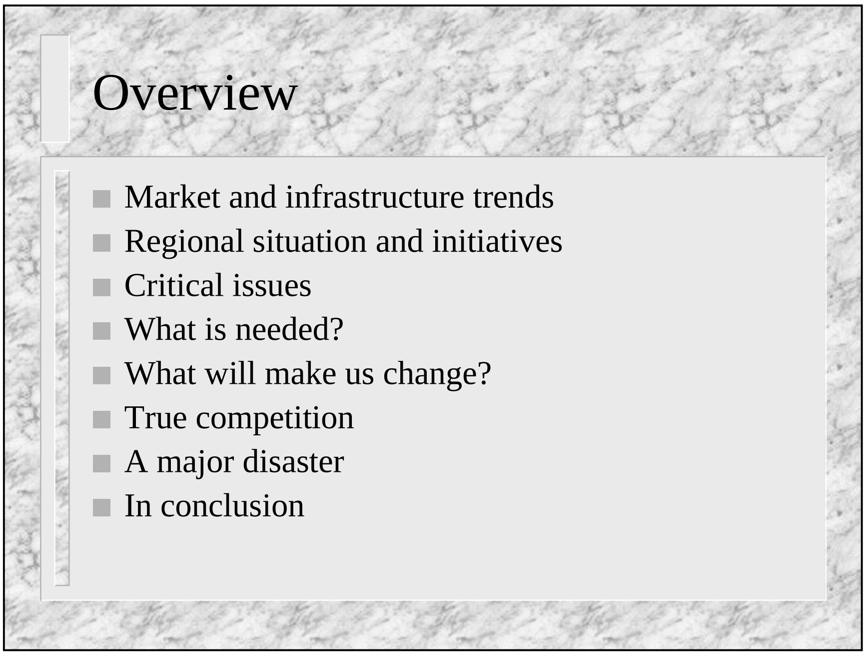


One of the things I always found when I was in the industry, was a very simple logic that said "He who controls the market, controls the profits". If we are trying to draw the roadmap to the future, one of the relevant questions to ask is "Who has the most to lose?" We need to look at the different infrastructure trends and at the different players in the market place.



I tried to make this introductory presentation international rather than European, but the European dimension tends to dominate the discussion. I will look at some critical issues, at the need for change, and what might give us the impetus for change.

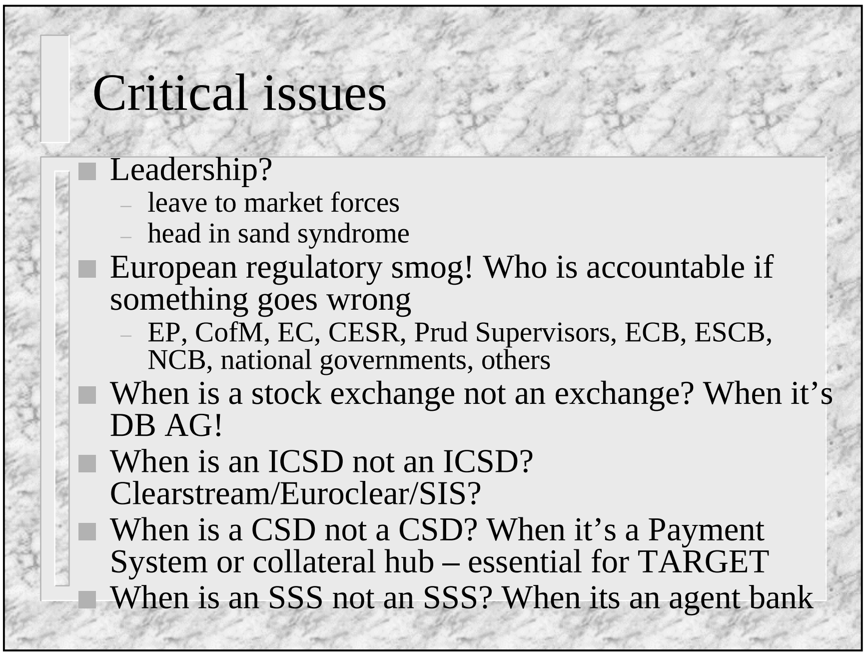
When it comes to the process of managing change, one of the old and trusted principles you can rely on is "If you cannot beat them with science, you can baffle them with bullshit". A great deal of that goes on in the market place at the moment! It is a sign of ignorance which means that there is a lack of knowledge. This form of ignorance is not really an insulting term, it just means that we are moving around in the midst of a very complete set of equations.

I want to talk about the consolidation process. I have the advantage to have worked for both a stock exchange and an international clearer. Looking back to my time with the London Exchange, my initial comment applied there well: "He who controls the market, controls the profits". We had 5'762 jobbers or brokers, most of whom were sometimes active on the trading floor, and the oldest of whom was 92 years of age. At the time of the Big Bang, the London Stock Exchange was a perfect vertical silo. The people who brought an issuer to market were the same group that had an involvement with the stock exchange. Those who then traded the issue in the secondary market happened to be members of the stock exchange. The 5'762 members were controlling the profits. How did they do it? Quite simply, they arranged themselves into committees. We had 14 standing committees and 172 subcommittees. One thing I learned there was that committees do not work. There had to be an external impetus for change. The government and the market regulator decided that they had to come up with changes, as they came to view the exchange as a case of restricted practice. They then created the Big Bang and many people remember it as some form of technological revolution around the introduction of market making. In reality it was very simple, it was the elimination of fixed commissions. It caused a move to automated electronic trading. Eventually, market making was found to be a restrictive practice, too, so we implemented an order-driven market.

Where are the stock exchanges going today? Right now, there is no real competition in Europe. Competition among stock exchanges is a highly political topic, but there is much talk and little real action.

When you come away from the simple idea of "who controls the profits", then you get into a situation which is a good example for using Michael Porter's equation: On the one hand you have customers, on the other hand you have suppliers. You also have competitors and you have regulators. These influence the change program. The question is to those who control a profit element in their market: How do you see that in your own business dimension? Depending on whether you are a CSD, or an agent bank, or a broker/dealer, you would have a different view.

Each of the world's major regions, and the sub-regions in Europe, are moving at different speed, they carry different baggages of history, they have different experience curves, different embarrassments as well. All of this influences our course of change. The term "different disasters" has a significant impact on that process. Then we have definitional issues. When we say Europe, are we actually talking about the European Union of 12 members, the enlarged EU of 25 members, or geographical Europe?



When it comes to implementing change, leadership counts a lot. When the London Stock Exchange was unbundling its vertical silo, there were three men building vertical silos up at the same time; in Paris, Frankfurt and in Amsterdam. Others copied the vertical approach later (the term "vertical silo" was actually coined much later because nobody cared back then). Leadership was important, and those changes were driven by a few men with visions. Market changes and consolidation in every industry, generally, should be left to the market forces.

"Regulatory smog" is a complication to implementing change, particularly in Europe. I am alluding to the question of who is actually leading the process of change when it comes to regulation. I can't find anyone in Europe who is leading this process. I find it very difficult see where powers have been granted to people to lead the change, and therefore I find it very difficult to see who would be accountable in the event that something went wrong.

I then pose some other questions: When is a stock exchange not an exchange? Deutsche Börse is a very good example. Many people like to think that Deutsche Börse is an exchange. In reality, all the local German exchanges still exist, they have their own governance. They just happen to use a supplier called Deutsche Börse AG which is actually a software factory. It is in a different league when we examine the securities market infrastructure.

When is an ICSD not an ICSD? These days it would appear when you are Clearstream, Euroclear or SIS, because they are all hybrid models. They are both domestic and international in their dimension.

When is a CSD not a CSD? When it is a securities settlement system! Just to be a little controversial, I would say when it is a payment system or a collateral hub. I find it difficult to separate the notion of securities settlement in the process when it comes to payment and collateral mobility. If you remember the conventional securities transaction value chain, it is interesting that the payment and the collateral management functions are always missing. And there is an added dimension to it in Europe: In Europe we lost the CSDs. We now talk about Securities Settlement Systems, and we even have agent banks considered to be Securities Settlement Systems.

When you get into the process of managing change, one of the key issues is how to define the functions. This is of a very keen interest to the regulators at the moment. They believe that there need to be functional definitions in order to separate what may be monopoly functionality from what may be general banking functionality. It is very difficult to make sound definitions. Today, the move to risk mitigation has been the move towards real time gross settlement in central bank money, with legal finality, and with the immediate re-use of cash. I am not sure if, with this definition, I described a settlement system for securities or for payments. In reality, they have converged. You would find that the regulators will immediately take hold of that and say "No, that is not a functional definition", because I included prudential supervision requirements, and national central bank requirements, or European Central Bank requirements, and those guys do not agree!

So, where is the commitment to change? Throughout my career on business, one of the recurring themes was about consensus building. That seems to be very important, particularly if you leave the changes to the market forces to decide. All of us can quickly reach agreement on the distinction between the activities of broker/dealers, agent banks and CSDs. Then it starts to get messy.

There is a great deal of political being upheld between the exchanges. The exchanges in Europe talk a lot about competition but, in reality, there is very little competition actually going on. In a situation like this, something has to force the change. What is that "something"?

Standards: It is difficult to see how standards will be applied other than through moral suasion - that is a term often used by central banks. My experience is that typically, unless there are legal powers and accountable structures, that does not work too well.

So what is then needed to bring about change? There is a strategic methodology which calls for a vision, a common understanding and an agreed urgency to implement. The question of course is "What is the vision?" Is the vision to eliminate risk? That would be a reasonable one. Is the vision to have competition? I am not sure because standards tend to imply consolidation and when you get into that track, you very quickly end up with polarisation. You see the emergence of a few very powerful players and you are back to "He who controls the market controls the profits."

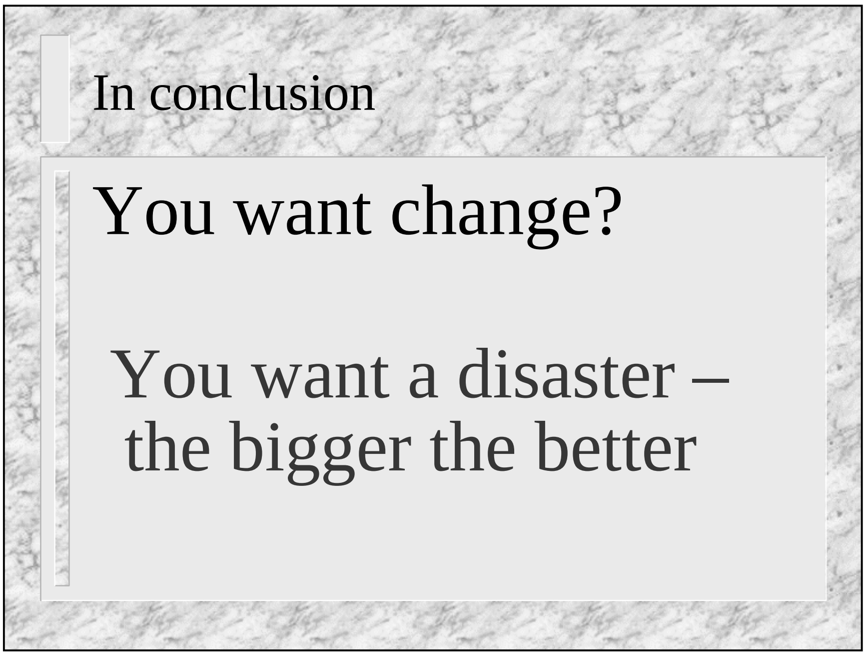
In that process, there needs to be true competition. We will neither get it from European, nor from American, nor from Asian stock exchanges. To be blunt, competition is a fallacy in that field even though some of the exchanges have demutualised. I always note in this context that London has demutualised. Where we used to have 5'762 jobbers and brokers on the floor, there is not one British-owned investment bank left today. That is the stark reality of change. Therefore, one effective means to bring about change is through substitution. But the best of all is "Lets have a good disaster!".

So, we have two of major scenarios to examine more closely - first, true competition. In this scenario you have all these wonderful discussions about leadership, vertical silos, substitution, level playing fields, fewer standards bodies - because lets face it, if you have true competition you do not need standards bodies anymore! You end up with fewer vested interest groups. You have more arbitrage even though the regulators do not like it, particularly not in the sense of regulatory arbitrage. But why should countries be exempt from competition? Why shouldn't they be different, even unique in certain aspects? If you compare the US and Europe, the US are an almost completely closed shop when it comes to stock exchanges. It can take several years even to get admission criteria. Whereas, in Europe which runs in regulatory smog, you can walk in very easily. When you have a fragmented market, you can join the game quite quickly.

The second scenario is the major disaster. September 11 was a good example. The extent of changes having taken place in the aftermath of 9/11 is amazing: War on terrorism, money transaction checks, introduction of new standards, business continuity arrangements. It is truly remarkable how there has been a common understanding of the need to change, there has been leadership in different parts of the world and an agreed urgency to implement. Of course I do not know where the next major disaster will hit, but it will come. It may be an issuer, it may be another Enron, a Parmalat, or the Sarbanes Oxley Act, which might make compliance with US requirements so expensive that issuers will not list in the US anymore. I am sure the American market might find that extremely uncomfortable. It might be the failure of a major European consolidation initiative. It could be post-trade systemic risk, for instance a major problem with a central counterparty. A central counterparty default might have a severe impact on securities and on payment systems at the same time. A major agent bank could be driven into bankruptcy in the process. TARGET failure - an interesting scenario... It could also be war, terrorism or an environmental disaster.

Lets go back to the "True Competition" scenario. I would like to quickly develop a kind of model. It could look like this: The Sarbanes Oxley Act may force companies seeking access to the capital market, not to list in the US anymore. They look for an alternative listing place. So I want a trading platform that allows for multiple listing arrangements spanning North America, Europe and Asia. I want a multi-faceted trading environment. I do not want a central order book because that is a natural barrier to Electronic Communication Networks (ECNs). So, I am going to leverage the notion of the North American markets with ECNs, creating some form of competition. In Europe there is no prospect for ECNs because when you have a central order book, it is very difficult to break the liquidity pool. And you have the Investment Services Directive that contains things like the concentration rule. It needs to be something different. You need a structure that is able to cope with large volumes, perhaps three times the daily NASDAQ peak volume, which is very sizeable. New issues should not be administered at all in a national CSD. I want them administered in an international setting, maybe using something like the common depository bank used by Clearstream and Euroclear, preferably with access to international clearing, because then you can use those links to get back into the US market. Euroclear and Clearstream, by the way, both have the ability to clear US securities under a regulatory exemption. But I also want the structure to give me access to the European and Asian markets. A European base would be ideal, because the European regulatory approach is much more flexible than what we see in the US or in Asia. Now this is of course a hypothetical case - or is it? Well in fact, this exists. It was called EASDAQ. EASDAQ designed a new trading environment which was scalable, based on three times NASDAQ's daily volumes. It had very efficient settlement links running directly and automatically into Clearstream and Euroclear and the securities were administered in an agent bank which acted as a common depository. I do not know why they gave up, because it seemed like the perfect competition model. If that could be resurrected, I think it would worry the European exchanges quite significantly!

Without wanting to be cynical, a major disaster is always a very good starting point to take a fresh look at things. It leads to action, creates leadership and a shared sense of urgency to question the status quo and to implement change if warranted. Usually, once the debris of a disaster is cleared, the situation gets healthier.



Working Group 1 - Clearing and settlement

- Define and set out one or two ‘critical issues’
- How should they be tackled?
- What methods would be appropriate, standards, lobbying, etc
- Where should ISSA focus its attention given its remit?
- Should ISSA commission research or establish sub groups?
- What policy statements/recommendations would be appropriate for ISSA to issue if any?
- What existing standards would require review or amendment?
- What impact would these have?

I propose to set up the two discussion groups along those two scenarios. One will look at the "conventional" way of identifying critical issues in our industry and how to deal with them. The second group will assume a worst case scenario. Based on that, using a kind of reverse engineering approach, it will discuss how such situation could have been avoided.

Working group 2 - Clearing and settlement

- Working group should use Murphy’s law
- What is the most likely ‘disaster scenario’?
- Given the chosen ‘disaster’ how would the group reverse engineer the process to avoid the disaster?
- Should ISSA commission research or establish sub groups?
- Should ISSA make explicit its position, recommendations?
- What policy statements/recommendations would be appropriate for ISSA to issue if any?
- What existing standards would require review or amendment?
- What impact would these have?