

May I begin by saying how grateful I am to be invited back to ISSA a second time.

Most people who invite journalists to any kind of event tend to find that once is enough.

As I know from bitter personal experience, journalists tend to behave badly.

They get drunk, they make indiscreet remarks, they break confidences- in extreme cases they even break wind.

Sometimes they make passes at the waitresses.

And that is just the custody journalists.

So imagine what might happen if you had not invited the editor of *Global Custodian* here today.

Imagine instead that you had invited the editor of a publication I came across for the first time the other day.

It was called *The Practical Hippie*.

Looking round this room I see one or two people that might be described as children of the Sixties

But, even so, I imagine that *The Practical Hippie* is not enjoying a wide readership in the securities services industry.

It is after all, the self-styled mouthpiece of the anti-globalisation movement.

And I found myself wondering how, an account of an event like this - the Twelfth ISSA Symposium - might appear in the editorial pages, of *The Practical Hippie*.

I think it might go something like this:

A cabal of top international bankers gathered secretly last night at a Swiss mountain hideaway to plot how to accelerate the pace of globalisation. Alarmed by mounting evidence of a popular backlash against the unfettered flow of capital across national and cultural borders, and growing resistance on the streets to the export of jobs to countries that pay starvation wages, bankers from 30 countries are meeting in emergency session at the aptly named Wolf Mountain retreat to plot how they can best achieve what they euphemistically describe as "a roadmap to the future" and "higher levels of efficiency" - but which we know in practice means the destruction of more locally owned and locally controlled jobs, businesses and communities in the ceaseless quest of international finance-capitalism for standardised, homogenised and commoditised markets, and the monopoly profits which flow from them.

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Of course, it does not feel much like that from the inside.

In fact, quite the reverse.

Most people here probably feel more like victims of globalisation than its architects, as we battle with competition, consolidation and shrinking margins.

Yet I believe there is a grain of truth in the world as seen from the editorial pages of *The Practical Hippie*.

If we do not always feel that we are in control of the forces that are assailing our industry, we do like to believe that we know what those forces are; that we can understand them; and that we can to some extent tame them, and shape them to our will.

The questions that we are asked to address today, which Joseph listed, I think reflect, perfectly, that vanity.

- How can we manage the forces of lower margins, rising regulation, consolidation, automation and internationalisation?
- How come nobody does what they are told at the end of our endless lists of ISSA recommendations?
- How can we jump-start a true process towards maximum efficiency?

- What are the mistakes that have prevented us getting there already?
- What are the obstacles we must overcome?
- What will the securities industry look like in five years' time?

To my mind, all of these questions embody a terrifying illusion: we think that we are in control of events – and that, if we are not, we ought to be, and it is only our own mistakes that have allowed events to get out of control.

Nothing symbolises that illusion better than the stack of reports that lies on the shelf next to my desk in London.

When I took them down last week, I found no less than ten of them, composed and published at various times between 1989 and 2004.

Doubtless there were others, which went from my desk to the dustbin, but these were the ten that mattered:

- Two from the Group of Thirty.
- One from the Group of Ten – I do not know if anyone remembers them, but the report was there.
- Two from the Giovannini Group.
- There was one each of course from the Committee of Wise Men, from CPS/IOSCO, one from ESF, one from CESR/ECB and there was one - easily the best one I am glad to say - from, of course, ISSA.

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15 Years, 10 Reports, 104 Recommendations

6-30 Recommendations of 1989	610 Recommendations of 1990	G30 Revised Recommendations of 1995	ISSA Recommendations of 2000	Report of the Committee of Wise Men February 2001	CPSS/IOSCO Recommendations for Securities Settlement Systems November 2001	Giovannini Report Volume 1 November 2001*	G30 Global Clearing & Settlements Plan of Action 2003	European Securities Forum Action Plan 2003	CESR/ECB Standards For Securities Clearing & Settlement 2004
1. Trade matching by T+1	1. Legal basis for netting	1. Trade matching by T+0	1. Primacy of users	1. Research benefits of single market	1. Clear legal framework	1. Open access to CSDs and CCPs	1. Less paper and more automation	1. Harmonisation of CSD procedures and timetables	1. Legal certainty
2. Trade affirmation	2. Risk assessment for netting	2. Trade affirmation by T+1	2. Open access to CSDs and CCPs	2. More capital for SMEs	2. Trade matching on T+0	2. Harmonisation of corporate actions	2. Standardised messaging	2. Harmonisation of corporate actions	2. Trade matching
3. A CSD	3. Multilateral netting procedures	3. Standardised CSDs	3. ISIN numbers	3. List legal fiscal and trade barriers	3. Rolling settlement on T+3	3. Central bank money is preferable	3. Standardised reference data	3. Open access to CSDs and CCPs	3. Rolling settlement on T+3
4. Netting	4. Post-netting settlement	4. RTGS or netting	4. Segregation of assets	4. Regulatory convergence	4. CCPs may be a good idea	4. Freedom to hold assets in any CSD	4. Harmonised settlement timetables and procedures	4. Integration and consolidation of CCPs	4. CCPs are a good idea
5. DvP	5. Netting system admission criteria	5. Well-defined DvP	5. DvP	5. CSD convergence	5. Securities lending and borrowing	5. End to obligation to use a CSD	5. Trade matching	5. Harmonisation of tax reclaim procedures	5. Securities lending and borrowing
6. Same-day funds	6. Back-up of netting systems	6. Same-day funds	6. Settlement on T+1	6. Regulatory co-operation	6. Paperless settlement	6. Tax relief at source	6. CCPs are a good idea	6. Legal certainty	6. Paperless settlement
7. Rolling settlement on T+5		7. Rolling settlement on T+3	7. Securities lending and borrowing	7. Spend more money on compliance by member states	7. DvP	7. Transaction tax collection by CSDs is a bad idea	7. Securities lending and borrowing	7. Paperless settlement	7. DvP
8. Securities lending		8. Securities lending and borrowing	8. Netting	8. Spend money on regulatory training	8. Real-time settlement finality	8. Legal certainty across borders	8. Standardised asset servicing (e.g. corporate actions)	8. Regulatory convergence	8. Real-time settlement finality
9. ISO 7775 and ISIN numbers		9. ISO 7775 and ISIN numbers	9. Cross-collateralisation	9. Improve policing of non-compliance by member states	9. Better risk management by CSDs (i.e. credit limits and collateralisation)	9. Real-time settlement finality	9. Better risk management by CSDs and CCPs		9. Better risk management by CSDs
			10. Paperless settlement	10. EU-level regulatory "principles"	10. Central bank money is safer	10. Legal certainty in netting	10. Even better risk management by CSDs and CCPs		10. Central bank money is preferable
			11. Trade matching	11. More consultation with market participants	11. Institute BCP planning and minimise operational risk	11. More legal certainty (ac) on clashing national laws	11. Real-time settlement finality		11. Minimise operational risk
			12. Consolidation of CSDs	12. Establish two new committees: ESE and ESRC	12. Segregation of client assets	12. Real-time settlement finality (again)	12. Institute BCP planning and minimise operational risk		12. Segregation of client assets
			13. Reciprocal compliance	13. Yet more consultation with market participants	13. CSDs and CCPs to be governed in interests of users, owners and public	13. Harmonisation of CSD and CCP procedures	13. Decide what to do if procedures in (12) fail		13. CSDs and CCPs to be governed in interests of users, owners and public
			14. Legal certainty across borders	14. Regular reports to European Parliament	14. Open access to CSDs and CCPs	14. Harmonisation of CSD and CCP timetables	14. Greater legal certainty		14. Open access to CSDs and CCPs
			15. Regular comparisons and reviews	15. Tighter enforcement of EU rules	15. CSDs and CCPs should have low fees	15. Standardised messaging	15. Greater legal certainty on collateral		15. CSDs and CCPs should have low fees
			16. Tighter enforcement of EU rules	16. Standardised messaging	16. Standardised messaging	16. Standardised IPO procedures	16. Netting		16. Standardised messaging
			17. Institute fast-track regulatory approvals	17. Cost transparency at CSDs and CCPs	17. Cost transparency at CSDs and CCPs		17. Put people like us on the boards of CSDs and CCPs		17. Cost transparency at CSDs and CCPs
			18. Work for eventual regulatory convergence	18. Regulatory co-operation	18. Regulatory co-operation		18. Open access to CSDs and CCPs		18. Regulatory co-operation and convergence
			19. Six monthly monitoring of regulatory procedures	19. Cross-border links between CSDs	19. Cross-border links between CSDs		19. Primacy of users		19. Cross-border links between CSDs
			20. Full and open review of progress in 2004				20. Regulatory convergence		

*Giovanni Group II covered only a strategy for implementation

This slide says it all really.

It attempts to summarise what those ten reports thought the securities industry should be doing to make itself safer and more efficient.

What we have here is a total of more than 104 separate recommendations.

Even by my wife's standards, those are a lot of recommendations.

Even if we managed to implement one recommendation a week, it would still take us two years.

The good news is that we do not have to do that, because there is actually a lot less here than meets the eye.

Some of the recommendations are simply self-serving - we do not really need to take them seriously at all.

My personal favourite is Recommendation 17 of the second Group of Thirty report, where the industry is told that what it really needs is the "appointment of appropriately experienced and senior board members."

In an industry with as many appropriately experienced and senior members as this one, I do not think that is an incentive the industry needs.

The same self-interested logic suffuses the whole of the report of the Committee of Wise Men.

When I sat down to try and summarise what its 19 recommendations actually said, this is what I came up with.

"Please set up lots more committees like this one, and appoint lots more people like us to sit on them, so we can liaise, and monitor and co-ordinate the work of other committees, in exchange for emoluments at our usual daily rates."

But even if we dispense with recommendation 17 of the second G30 report, and if we dispense with the whole of the Committee of Wise Men Report (and I think we should) that still leaves 84 recommendations untouched.

Or does it?

A closer analysis of the 84 remaining points shows that many of the recommendations are not actually new at all.

They are merely repeats, or refinements of ideas put forward either in the original Group of 30 report or in subsequent reports to that one.

Once we strip those out, we end up with just 20 new recommendations.

One in Five Recommendations is Genuinely New

<u>Source</u>	<u>Number</u>
Original G30 Recommendations	9
Repeats of the Original G30 Recommendations	36
New Recommendations	59
Repeats of the New Recommendations	39
Residue of the New Recommendations	20

Or do we?

Without too much fiddling about, we find that a dozen of these 20 ideas are actually little more than the same old ideas in a new or refined forms.

Two in Three New Ideas Turn Out to Be Old Ideas In Refined Form	
<u>The Original G30 Recommendations of 1989</u>	<u>New Ideas that Turn Out to Be Old Ideas in Refined Form</u>
1. Trade matching by T+1	
2. Trade affirmation	
3. A CSD	1. User Governance of CSDs 2. Open access to CSDs 3. Consolidation of CSDs 4. Links between CSDs 5. Cost transparency at CSDs 6. Lower fees at CSDs 7. Harmonisation of CSD procedures
4. Netting	8. CCPs are a good idea 9. Collateralisation is a good idea
5. DvP	
6. Same-day funds	10. Central bank money is preferable 11. Real-time settlement finality
7. Rolling settlement on T+5	
8. Securities lending	
9. ISO 7775 and ISIN Numbers	12. Standardised reference data

Which means we are left, in exchange for something like 14 years' work, 632 pages of text of closely argued text, and goodness-knows-how-many man-hours of work, with just eight more ideas.

And that is just the stuff on my shelf.

This is what they are:

A Short Summary Of Ten Years' Work
<u>Genuinely New Ideas</u>
1. Regulatory convergence (or reciprocal compliance)
2. Legal certainty across borders
3. Business continuity planning
4. Management of operational risk
5. Tax relief at source
6. Standardised corporate actions processes
7. Segregation of client assets
8. Standardised messaging

Doubtless, if they were adopted, the securities industry would be a lot safer and more efficient than it is.

So why don't we?

The answer of course, is that we are getting on with them already – or at least half of them already.

We probably cannot do a lot about the other half, because they require political action, or legislative change – and not just in one country, but in dozens of different countries.

Which Of These New Ideas Can The Industry Do Something About?

For Politicians:

1. Regulatory convergence (or reciprocal compliance)
2. Legal certainty across borders
3. Tax relief at source
4. Standardised corporate actions processes

For Practitioners:

1. Business continuity planning
2. Management of operational risk
3. Segregation of client assets
4. Standardised messaging

In other words, we can file at least half of these 8 new ideas under "F" for Fat Chance.

And the other half?

We are doing them already.

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The question is, what does all this tell us?

I think it tells us a number of interesting things.

First, that nobody reads industry reports, including the people who write them – because otherwise somebody would have noticed before they were recommending exactly the same things as the last bloke.

Secondly, if you ask a group of senior and experienced people to write a report on a problem, chances are that they will conclude that the answer to the problem lies in appointing senior and experienced people to form a committee to solve the problem.

Third, and more importantly, what this list of recommendations really teaches us is that what changes behaviour is not lists of recommendations, but financial pain and meaningful loss.

The ideas that have really stood the test of time – which have been adopted, if not completely, or in the form originally intended – are those which were forged in the settlement crisis of the late 1980s.

Much of what has been published since March 1989 is really no more than refinements of those original nine ideas.

Fourthly, what is new, genuinely new, in the great list of recommendations that have been published since then has also tended to be forged in a crisis.

Interest in central counter-parties and collateralisation, for example, dates back to the Russian debt crisis of 1998 and the LTCM crises of the same year; disaster recovery and business continuity planning really took off after 9.11; and interest, of course, in the hidden value locked up in tax reclaims and corporate actions was born in the prolonged bear market of the years between 2000 and 2003.

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In other words, far from being in control of events, events are really in control of us.

Far from following some pre-planned roadmap to the future, we merely carry on doing whatever we are doing, until we are shocked out of it by some supreme crisis that demands we change our behaviour.

The fact that we keep churning out these lists of recommendations is simply a reminder that we refuse, somewhere inside us, to believe this.

We love the illusion of being in control.

If you think the illusion of being in control is harmless, think again.

It encourages us to believe that what we are doing is not an unending process of discovering-and I use the verb "discovering" advisedly, instead of "finding " - ever more efficient solutions to the problem of efficiency, but proceeding steadily along our Roadmap to the Future, to a final an end-state of 100 per cent efficiency - a place where all our problems are resolved, and where there are no exceptions to be processed, and we have reached a state of Straight Through Processing which is, by definition, unimprovable.

Now to get there, we have placed our faith in two principal means.

First, automation.

Secondly, standardisation.

There is nothing intrinsically bad about either of these things.

Nobody (except trade unionists) disagrees that higher rates of automation are a desirable thing: they lower costs, and improve quality.

Nobody disagrees that standardisation is the best means by which to raise rates of automation.

But we need to recognise that automation and standardisation are extremely powerful tools.

Put them in the wrong hands, and bad things will happen.

If they are misused, they could lead to a potentially ruinous restructuring of the securities services industry.

And in my judgement, they are already doing so.

Let me explain.

In any industry, automation plus standardisation equals commoditisation.

And commoditisation is a dangerous condition, for two reasons.

First and least importantly, it encourages us to believe that we can deliver a commodity service.

We believe, for example, that outsourcing - first of custody, then of fund administration and transfer agency, next perhaps, or private equity administration, or maybe private wealth management - can be sold and delivered on an undifferentiated basis.

This is quite wrong.

The most important trend affecting our industry is not standardisation - it is *specialisation*.

The vertically integrated companies of the classic industrial age were set up to do everything in-house, because it was too costly to coordinate dozens of different suppliers.

The transaction costs were simply too high.

In the information or digital age, in which we live and work, the costs of co-ordinating dozens of different suppliers is much lower.

In this environment, what counts is being supremely good at one thing - not being mediocre at dozens of different things.

Secondly, and much more importantly, commoditisation is a dangerous condition because it creates equal scope for the supreme good (by which I mean competition) and the supreme evil (by which I mean monopoly).

On the one hand, commoditisation makes it easier for competition to develop because the products and the services are commodities that are fully fungible.

In fact, competition is always most intense in precisely those products that are most alike - because the one can be easily substituted for the other, and all that has to be compared is the price.

Think of Coca-Cola and Pepsi, or household gas, or gasoline.

On the other hand, it is when a product or service is commoditised that we are most likely to conclude that competition is pointless.

Why have six different firms producing indistinguishable products and services, when you could have one?

Is it not wasteful for six firms to build exactly the same platform to provide exactly the same service?

Why do we not just build one platform, each take a share in it and a seat on the board, and set prices on a cost-plus basis?

That, I am sure you will recognise, is a pretty accurate description of what happened to securities clearing and settlement in the United States in the 1970s.

It is also a pretty good summary of one school of thought about the future structure of clearing and settlement in Europe in the early 21st century.

And it is a school of cartelisation.

And it is not hard to work out why the cartelisation of clearing and settlement appeals to certain market participants.

Every commercial enterprise – and *Global Custodian* magazine is no exception to this rule – would like to have an official dispensation from competition.

If responsibility for these so-called commoditised or standardised or automated functions could be shifted into some public utility that we own and we control - in terms of both ownership and the board room – you can raise the barriers to entry.

You can prevent a competitor using those so-called commoditised revenue streams to build a competitive business against you, perhaps by using new or better technology.

Why else do we hear how expensive it is to build a CSD?

Why else do we hear so much from custodian banks about the enormous size of their IT budgets?

Why else do we find the CSDs and ICSDs trying to get the custodian banks dubbed as “systemically important,” so they can be hobbled by regulatory burdens they do not have to share?

If settlement is commoditised, why is it so difficult to get a meaningful price list from CSDs or ICSDs?

If CSDs and ICSDs are really user-owned and user-governed, why cannot we read in the annual report what the directors are paid?

If CSDs and ICSDs are really meant to be providing services on cost-plus basis, why do we not know more about how those costs are incurred?

Why is it so hard to understand the impact on your business of a so-called price cut by a public utility?

Why are we working in an industry in which firms can seriously say to some of their customers, ‘We don’t want to work with you, Mr Customer, because you are much too inefficient for us to be bothered with?’

Why do we not have a proper market in securities loans?

Why do people continue to use the SWIFT messaging network when there are alternatives out there which are cheaper and just as secure?

Why do I notice – to take an example close to my own heart – how a number of people and firms who participate in our client perception surveys seem much more interested in managing the survey process than in managing the business problems which the survey identifies?

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These are rhetorical questions.

But they are also symptoms of an industry which is close to oligopoly.

An industry which lacks transparency.

An industry which is in increasing danger of cartelisation, in the sense that competition on price and service is more theatrical than real.

An industry which is closed to new entrants, even if those new entrants have cheaper technology and better ideas.

An industry which is much less interested in its costs than it would have us believe.

The result is the long run will be the creation of an inferior and more expensive market infrastructure, in which the providers feel better off, but everybody else really is worse off, because they are paying higher prices for inferior service.

Think, for example, about why the ICSDs have found it so difficult and so expensive to build a single processing engine.

Why do they want to build one anyway, and especially at your expense?

After all, they could use what they've got already: believe it or not, it really can make sense to run old technology into the ground.

And even if it does not, they could ring up our good friend Jens Bache and buy one of his CSDs in a box for £20,000 - or whatever it costs.

A lot of CSDs do not do this because they have no incentive to be quick, or inventive, or cost-conscious: they know people *have* to use their services, whatever they do.

Take another example.

Ask yourself why SWIFT has found it so difficult to persuade fund managers to adopt its message standards.

Or why Omgeo has found it so difficult to persuade them to switch to the CTM.

The answer is pretty obvious really: they find the price too high and the benefits too limited to want to make the payment.

But in a world without competition, in the long run SWIFT can (and almost certainly will) force firms to adopt its protocols by fining those who do not.

And Omgeo can (and almost certainly will) force its customers on to the CTM by the simple device of switching OASYS Global off.

For all I know, SWIFT message standards and the CTM may be, respectively, the best of all possible message types and the best of all possible central matching engines in the best of all possible worlds.

But somehow I doubt it.

Standards imposed by experts are rarely the ones that market participants can use.

They are more likely to be the "wrong" standards, even if they are the "best" ones.

As anybody familiar with Microsoft products knows, the most useful standards are not always the best ones.

Besides, facts change.

Technology changes.

Understanding improves.

Why lock ourselves into a standard, when you know that your knowledge is partial?

Think back to the debate in the mid-1990s about Real Time Gross Settlement and Netting.

RTGS and Netting were seen as alternatives, because in those days everyone assumed that netting had to take place at the settlement level.

We now know that it has to take place at the clearing level.

But if the industry had insisted on RTGS at the settlement level, perhaps we would never have enjoyed the benefits of netting.

It is always wiser to discover the "right" standard by a process of trial and error - by competition, if you like, between standards.

And that competition must never stop: competition is not a one-shot exercise.

No choice we ever make is a final one.

Every choice we make forces us to make other choices.

Think, for example, of those who want a single European CSD.

They have to tell us how they will prevent it exploiting its monopoly power by reducing output and raising prices.

Those of us who do not want one, on the other hand, must tell us how to make competition between CSDs effective.

It is a good example of how every choice will raise at least as many questions as it answers.

So every choice should always be provisional, because every choice will contain errors.

Every choice is bound to create winners we did not intend to reward, and to penalise losers we did not intend to penalise.

We live, in short, in a world of the second-best – and should not even imagine that it is possible to live in the world of the best.

So if you ask me, ‘What will the securities services industry look like in five years’ time?’ there is only one sensible answer that I can give.

It is: ‘I don’t know.’

And I don’t know, because I cannot know.

We lack the information – we lack the skills to gather the information, we lack the analytical tools to make sense of it.

The idea that we can set out the ideal world of securities services in the next five years, even the next 5 hours, in a list of recommendations, or implemented recommendations, is a logical impossibility.

What I do know is that if we continue on the present course – the course of commoditisation, leading to consolidation, leading to cartelisation – nothing very much will change at all.

Far from becoming more efficient, the industry will become frozen at a particular stage in its development.

To avoid that fate, we must not sit here working out how to accelerate the implementation of the Group of Thirty recommendations.

We must not sit here trying to work out who is in charge of that process.

We must abandon the recommendations altogether.

They are not the work of Wise Men, but of Mad Men – men who believe that there is a Roadmap to the Future, that we can find that road map, and that we can tread our path along it.

We must abjure them.

We must abjure them and their reports.

We must abjure all schemes of general improvement.

We must abandon our grand visions - our total visions.

We must recognise that there is no such thing as the common good of the securities industry.

We must become, in a word, more selfish.

We must invest only in what pays us.

We must invest only in those products which make sense for us.

We must innovate only where it makes sense for us.

We must take risks only where it makes sense for us.

We must rejoice in being the businesses that we were meant to be: commercial enterprises, judged by shareholder value, and pursuing strategies to deliver it that have no purpose in mind beyond the making of money – and which actively *despise* the idea that we owe any duty of efficiency to others, or they to us.

In other words, my prescription for change is this: do nothing, except make money.

I know how hard it is to believe that doing nothing is better than doing something.

But I believe we must free ourselves from the illusion of control imposed upon us by the G30 and other reports.

If we have the courage to do it –if we have the courage to step off the Roadmap into the Future, into the unknown, the uncertain, and the insecure – into the realm of the purely selfish, I think we will surprise ourselves.

Not by how little progress we make.

But by how much.

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