

They say that a journalist's idea of Heaven is a bar that never shuts.

And that his idea of Hell is having to speak to anyone before 9.00 in the morning.

Which means that I have passed from Heaven to Hell in just a few hours.

So if the remarks that follow bear no relation to what happened yesterday, please understand that they were written during a time when I am normally drunk, and delivered at a time when I am normally asleep.

Competition

We began with Competition.

Question 1: Which is the highest priority for user-owned, user-governed market infrastructure operators: users or managers?

Participants were asked first whether they thought user ownership and governance was a synonym for ownership and governance by management.

To my dismay, there was a robust consensus that user-owned, user-governed entities are a terrific idea.

Properly designed, they cannot be run in the interests of their managers, but deliver concrete benefits to users.

Chief among those benefits are the reduction of costs and the reduction of risks.

However, there was a recognition that the corporate governance structure had to be designed carefully to eliminate the conflict of interest faced by the managers of user-owned, user-governed organizations.

First, managers had to be incentivised to reduce costs and minimize risks.

(Looking at our advertising revenues over the last three years, that is certainly an incentive I could live with: being paid to reduce revenues.)

Secondly, those financial incentives must be devised by remuneration committees appointed by the users.

Thirdly, there must be full transparency on costs, revenues and charges, policed by an independent audit committee.

Fourthly, drawing on an example in Canada, a further safeguard might be the appointment by users of non-executive directors.

Whether user-owned and user-governed entities are run for profit or not was regarded as a second order matter.

In fact, so much were users opposed to the idea that managers could run a user-owned and user-governed entity in their own interests, that users even began to ask themselves if the fault did not lie with them.

Perhaps it was they - the users - that faced a conflict of interest.

Direct users, for example, might be tempted to exaggerate to their clients the costs of using a market infrastructure they controlled, knowing that they would enjoy a slice of the additional profits when the dividend or rebate season came around.

As Diana Chan pointed out, in a long philosophical passage heavily influenced by Ruben Lee, in securities market infrastructure reform, everything is not necessarily as it seems.

An eminently sensible suggestion was made that we need competition between forms of ownership and governance as well as for customers and capital – and that each is likely to strike a different balance between the claims of users or customers and owners or shareholders.

In other words, user owned and user governed entities should have to compete with different types of corporate organism, and users should be able to choose between them continuously.

But the job of promoting that competition is not, it seems the role of the regulators alone.

On question 2 ...

Question 2: Do regulators exist to promote and maintain competition only, or do they have wider responsibilities?

... there was an equally robust consensus that regulators should not be confined to policing competition only.

Regulators have an important role to play in protecting investors – especially retail investors.

And in guaranteeing access to market infrastructures

In ensuring transparency in pricing.

In maintaining the stability of the financial system.

And, last but not least, in making market infrastructures invulnerable to external attack or systems failures.

Co-Operation

We turned secondly to the question of co-operation.

On this subject views were more divided than they were on the competition question.

Asked ...

Question 3: Which parts of the securities industry do not benefit from competition and should instead be managed co-operatively?

... one group assented to the proposition that national monopolies in clearing and settlement should be eliminated by being taken into public ownership, and forced to comply with an agreed set of standards.

The same group also argued that competition between regulatory regimes should be ended forthwith.

But then the same group also assented to the proposition that there ought to a Darwinian selection of the fittest, in which not only clearing and settlement services but regulatory regimes, ought to be pitted against each other.

Which all goes to show that I am not alone in believing two contradictory propositions at the same time.

Indeed, I believe that I played a key role in these mutually exclusive conclusions by means of a deeply confusing and irrelevant digression on the question of public goods.

A lone voice argued that the strongest basis for a fully publicly owned, consolidated infrastructure is that liquidity in netting and settlements concentrates as surely as liquidity in trading, because of the network effects.

Other groups, obviously less confused by what I had to say, made serious efforts to address the question: What is a public good?

Or, to put it in terms not found in the Bluffer's Guide to Economics, what exactly is in the area reserved for collaboration?

One group came up with the following list of contents:

First, anything that strengthens the comprehensiveness of networks, in the sense of broadening the reach of markets, utilities and infrastructures to the maximum number of counterparts, so that the benefits of risk reduction and network effects are felt by everybody.

Secondly, anything that reduces systemic risk in the financial system must be put in the collaborative box – business continuity planning and disaster recovery were put forward as examples of this.

Thirdly, anything that increases efficiency, such as message standards, must be counted a collaborative undertaking.

A topical example of collaboration in order to reduce risks was identified in OTC derivatives processing, where market participants have already approached DTCC to create a solution after regulators expressed concern about the growing settlement backlog.

It was interesting to note, en passant, that the chief reason for turning to the DTCC was its familiarity – and, importantly, the fact that market participants had already invested in an interface to its services.

However, it was pointed out that market participants often came together to solve immensely complicated and potentially ruinous problems without the need for public bodies to get involved at all – as they had in tackling the Argentinian debt crisis.

Unfortunately, our trick question in the Co-operation section failed to trick anyone.

When asked ...

Question 4: Which co-operative initiatives would you be prepared to invest your own company's money in pursuing?

... nobody ummed and ahhed.

Instead, we learned that everybody would invest in anything which either made money, or saved money, or reduced risk.

There was no list of favourite projects, or single rule of thumb.

Whether they backed a project or not depended on the strength of the business case, and had to be judged on a case by case basis.

Consolidation

Which brought us to our final session, on Consolidation.

I thought our question ...

Question 5: Are there any viable alternatives to full scale mergers that would yield equivalent or greater benefits?

... was about inter-operability.

But I was soon put right on that.

Inter-operability was a stupid idea.

Anything that extracted either cost or risk from the market was desirable.

And spaghetti models designed to increase inter-operability between dozens of different entities probably increased costs and risks.

Certainly, inter-operability between unchanged entities is by definition going to add a further layer of costs on top of the costs of the fragmented infrastructure that you are trying to eliminate in the first place.

But inter-operability was not merely a bad idea: it missed the point as well.

The choice is not between linking up everything you have or integrating everything you have.

Consolidation through merger might be a desirable end-state, but you do not have to go there immediately.

There are plenty of quick, small scale wins to be had, which reduce costs and risks without necessitating wholesale integration of market infrastructure at the outset.

Solutions can evolve towards the ultimate goal of integration through a series of small, incremental steps.

TARGET 1, for example, was an inter-operating model.

It is TARGET 2 that is a single, integrated platform.

Similarly, Euroclear and Clearstream have built, and adapted over time an electronic bridge between their two organizations.

One interesting possibility was an adaptation of the outsourcing or shared services model, in which market participants come together to share the costs and benefits of using a common infrastructure without having to integrate anything at all.

Transactions banks of the French or German kind were examples of this that existed already.

Besides, mergers are not always initiated for the right reasons: managerial ego can play as large or larger a part than cost and risk reduction.

And ill-considered mergers can actually increase risk – by concentrating it in one place.

All of which argues for incremental steps and half-way houses that fall short of a merger but gradually build up an integrated infrastructure through joint ventures, white-labelling and such like.

Our ... Question 6: Is a consolidated infrastructure compatible with a responsive and innovative infrastructure?

... did not get kinder treatment.

Of course a consolidated infrastructure does not care about its customers, or try much that is new, we were told.

But it can be, as SWIFT is, safe and secure.

And to have those advantages of safety and security, it is well worth paying the price of having a dull and slow-moving utility.

That said, there was a recognition that competition is not just about lowering prices: it is about improving the quality of services by innovation too.

One view was that the collectively owned or collaborative infrastructure should be confined to basic services which there was no competitive advantage in supplying.

However, knowing where to draw the line between the commercial and the utilitarian is not as easy as it sounds.

What is clear is that the bigger and more comprehensive the consolidated infrastructure, the harder it will find it to innovate.

And the riskier - and perhaps the more expensive - it will be.

I draw comfort from that realization, and from one last remark.

It was pointed out that at least some global custodians are nowadays so much more cognizant of the service-enhancing, risk-reducing and cost-cutting benefits of competition that they are now parceling out their business among multiple sub-custodians in the same region to ensure that competition survives.

So we may be on course for a world of

- User-owned, user-governed utilities
- Rampant regulators
- Ever-expanding collaborative spaces
- Consolidating rather than inter-operating infrastructures

And a world in which safety and security count for as much as innovation and responsiveness to customers.

But competition clearly lives on in the hearts of all right-thinking network managers.
