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**Europe’s post trade arrangements: An outsider’s view**

Dinner speech to the Joint ECB-Commission Conference: “The safety and efficiency of post-trading arrangements in Europe”.

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Thank you, Mrs Tumpel-Gugerell, for those very kind words of introduction.

I would also like to thank the European Commission and our host, the ECB, for organising this conference, which on the evidence of today’s sessions will count as one of, if not the event of the post-trade year. Also I want to say what an honour it is to speak to such a distinguished group of experts.

I am, as you have heard, an outsider – a mere author and journalist. And I’m not sure who should be more nervous - me or the ECB, which invited me to appear before you tonight.

Dinner speeches are not part of my normal everyday life.

So I am doubly grateful to Gertrude Tumpel-Gugerell. Not just for the introduction: but also for some helpful advice.

When I was wondering what to say this evening I turned to the ECB website in search of inspiration and found some very wise words.

You, Mrs Tumpel-Gugerell, told a gathering a week ago that a dinner speech should fulfil two criteria.

It should not be too long and it should not spoil the mood of the dinner guests.

I shall do my best to fulfil the first criterion. But I have to be frank: some of you may feel by the end that I have not been quite so successful in fulfilling the second.

I feel I ought to apologise for this well in advance.

But I console myself with the thought that we are not here primarily to make each other feel happy.

We are here to debate an area of European finance that has been found wanting and in need of improvement.

The very format of this conference tells us that not all is well with Europe’s financial infrastructure. Although our meeting is entitled: “The Safety and Efficiency of Post-Trading Arrangements in Europe”, issues of efficiency take up the lion’s share of the proceedings.
The high level panel and five of the six sessions meeting today and tomorrow deal primarily with issues of efficiency, a code word for costs and competition, rather than financial stability.

These are not new problems. The incongruence of Europe’s mainly nation-based post trading arrangements with the Union’s aspiration to create a single market for financial services has been clear for a decade at least.

The issue was left - I think by neglect rather than by intention - to the private sector to resolve after the launch of the euro in 1999.

Four years or so of frantic corporate manoeuvring meant that everything was changed, but in the end nothing was changed. Indeed, if anything, the years from 1998 to 2002 saw the cementation of fault lines among Europe’s infrastructure providers.

To name one obvious division: On the one hand we saw a growing trend to vertical silos with trading, clearing and settlement grouped together in publicly quoted groups with a for-profit philosophy.

On the other, some horizontally arranged structures emerged with the support of user groups. In these, activities were grouped by function. To date they have achieved only a partial coverage of Europe’s financial market.

In reaction to the lost opportunities, we have, since 2000, witnessed the growing involvement of the European Union’s institutions in the sector.

But the more I have thought about the present state of post trading arrangements in Europe, the more I have been forced to conclude – reluctantly, I admit – that we may well be in another of those periods where everything will change. But in the end nothing will change.

And it was interesting to hear similar sentiments this afternoon from Bob Wigley of Merrill Lynch.

The Code of Conduct, T2S, CESAME, MOG – all these initiatives, all these acronyms – don’t seem to be bringing the desired efficient, low cost, post-trade environment that the single market needs.

Instead, I fear that they are providing a convenient smokescreen for many participants in this industry to continue as before – protecting vested interests in areas of activity that are lucrative, in large part because they are so little known and understood in the wider world.

It is not for nothing that post-trade services are known as the plumbing of the financial world.

As Commissioner McCreevy reminded us this morning, they are, like domestic plumbing, unglamorous activities that nobody thinks about until they go wrong.
These services also have other attributes that make them similar to domestic plumbing.

- As in the case of domestic plumbing, financial plumbing clearly provides a more than comfortable income for those engaged in its activities.

- And like domestic plumbing [and I speak with the experience of someone whose bathrooms at home were refurbished last year], the activities, processes and standards involved in the plumbing of the financial world can be extremely difficult for the outsider to understand.

The sheer complexity of Europe’s post-trade arrangements makes life difficult for outside observers, such as myself and - I suspect – for many policy makers.

When I was researching and writing my book, Plumbers and Visionaries: Securities Settlement and Europe’s Financial Market, I often felt that the skills acquired in nearly 40 years of journalism were woefully inadequate for the task of understanding what was going on.

- At times over those two and half years, I felt that it would have been better to have had the background of an anthropologist because the post-trading world in Europe seemed to have much in common with tribal societies.

And I was interested today to hear Jean-Michel Godeffroy also draw parallels with tribal life.

It was, I discovered, a world without a common language; where practitioners speak their own dialects and use their own definitions. Yet it is a world in which everybody on the inside knows everyone else.

This has created barriers to understanding between insiders and outsiders while fostering distinct forms of behaviour among insiders, who are experts, drawn from various disciplines and versed in the intricacies of processing trades.

Over time, the different tribes create and come to cherish their own distinct beliefs and practices. Some may believe in the horizontal structure, others in the vertical, for example.

As is often the way in tightly-knit communities, the post-trade world is one in which passions can run high and where comradeship can spill over into quite bitter rivalry.

But all tribes have a goal in common vis-à-vis the outside: which is to protect their vested interests.

- At other times – and in particular when viewing the corporate manoeuvrings of the late 1990s and the early years of this century – I thought that training in psychology could have been helpful.
These were the testosterone-filled years when the back office activities commonly categorised as plumbing acquired some of the cut and thrust more usually associated with investment banking.

While many of the decisions taken in those years appeared at first sight to be based on individual whims, closer examination usually pointed to the preservation or enhancement of vested interest as the motive.

- Then again, there were times when I thought the study of great power diplomacy in the 40 years before the First World War could help me understand what was going on.

Post-trade activities have provided a theatre for the prosecution of other conflicts in much the same way as the scramble for colonies in the late 19th century masked deeper divisions among the great powers of Europe.

One example of what I mean is the conflict that has been bubbling away between investment banks and exchanges to capture the rents from securities trading over the past couple of decades - and which has at various times been played out in proxy-wars in the post-trade environment.

The emergence of the horizontal-vertical controversy in the early years of this century can be seen in these terms.

So too perhaps can the current controversy about the competitiveness of clearing house arrangements for futures exchanges in London. I wonder whether this is not really a cover – a proxy battle – for the protagonists of different, if not changing, vested interests clustered around the vertical and horizontal models in securities clearing and settlement.

If so, this half-hidden tussle over the competitive clearing of equities - which involves the London Stock Exchange, LCH.Clearnet and SIS x clear, all of which are signatories to the Code of Conduct - has important implications for the future of the Code and the current EU strategy to inject more efficiency and competition into European post-trade activities.

The Code was – and indeed is – a bold experiment in light touch regulation. And, as someone who has a strong inclination to prefer market mechanisms to state intervention, it grieves me to query its efficacy.

But this is probably one of those moments when a degree of cynicism - a characteristic that many would consider inseparable from journalism - is called for.

And the cynic in me [as opposed to the wannabe anthropologist, psychologist or 19th century diplomat] has to ask whether the Code is a sufficiently robust structure to cope with a business sector that has been accustomed so long to live by its own tribal rules.

Codes and self regulation are in any case being subjected to a significant rethink in the light of the credit crunch.
Last week, when considering the idea of a code of best practices for the banking community, Martin Wolf, a distinguished former colleague at the FT, observed: “In such a fiercely competitive business a voluntary code is almost certainly not worth the paper it is written on”.

His observation has even greater validity for businesses – such as those making up Europe’s post trade infrastructure – that are being enjoined to sacrifice some of their profits for the common good.

It is no coincidence that the cracks in the Code are occurring in just that area where there was the greatest scepticism about its effectiveness: namely access and interoperability and where, ominously, the guideline agreed by the industry last summer runs to an indigestible 128 paragraphs.

It now seems clear, with hindsight, that the Code has inadequate teeth.

And with due respect for Commissioner McCreevy’s assertion of this morning that he will not accept “endless foot-dragging”, it is pertinent to ask:

- How effective can the Commission’s threat of action be under the treaties or of a directive [its sword of Damocles over the signatories of the Code], when we know that the Commission has entered its final lap before replacement next year?

- Whatever happened to the idea of naming and shaming delinquents and backsliders among these signatories?

- What has happened to all the talk of the Commission’s competition department acting to stamp out “uncompetitive behaviour and unsavoury practices”?

Reluctantly, I’m coming to the conclusion that Europe’s post trade arrangements will not be sorted out without official intervention and that the current phase of activity will be seen as an interim phase at best.

But if the answer lies in public intervention, it needs to be intelligent intervention that addresses the problems at the heart of Europe’s post trading arrangements.

We must not forget that public sector institutions are just as liable to have - or to be captured by - vested interests as are actors in the private sector. For this reason, public sector players must examine rigorously, and be held to account for, the motives behind their policies.

Here – with due respect to our host this evening – it is understandable that some market participants should query whether Target 2 Securities is what this sector really needs.

Is it indeed a very clever answer to a second order problem: a way of resolving a split that existed in the ECB’s governing council between protagonists of the integrated and interface models of securities settlement. But is that a sensible base on which to create a new model of infrastructure?
Clearly much will depend on the business case that the ECB will make for T2S.

I hope that these questions, and others, will be satisfactorily answered before T2S is given the go-ahead. If they are, we can all look forward to its successful launch in five years time without feeling queasy.

It is not just the ECB that needs to provide answers to questions, of course.

Why have EU governments not yet found the political will to eliminate the legal and fiscal barriers that were identified by Alberto Giovannini and his group of experts six and a half years ago?

The private sector has probably gone about as far as it can in removing ‘its’ Giovannini barriers in the absence of supporting action by governments.

And I wonder here whether, given the importance of the fiscal and legal barriers, it would not be a good idea to have some sort of representation of governments – especially finance ministries – in the CESAME 2 group that is due to carry on the work to remove the Giovannini barriers from this summer.

Now, I am conscious that I am in danger of failing one of Mrs Tumpel-Gugerell’s criteria for a dinner speech: not to talk for too long.

And I have probably gone as far as I should in my various criticisms if I am not to spoil the mood of this gathering.

So to conclude, I would like to leave you with two thoughts – or questions - which look ahead to tomorrow’s sessions, and, in so doing, I hope to end my remarks on a rather more hopeful note.

First, I wonder whether – as so often in the past – we in Europe are not in danger of engaging in navel gazing on the issue of post-trade arrangements.

We were reminded this afternoon of the trans-Atlantic developments on the exchanges, such as the creation of NYSE-Euronext and NASDAQ’s takeover of OMX.

It is worth asking whether or not there will be a transatlantic flavour to the next big development in Europe’s post-trade arrangements.

There are portents already in the clearing space – just reflect on the arrival of Euro-CCP and its ambitions to be the central counterparty clearer of choice for MTFs as well as the controversy about clearing in London that I touched on earlier.

And to end on a positive note, I would like finally to look briefly at an area about which Europe’s post trade infrastructures can feel justly satisfied, and ask if it has any lessons for those seeking to make the industry more efficient.

I refer here to the issue of safety which is one of the themes to be discussed tomorrow.
We are meeting nearly nine months into a global credit crisis in which many, if not most, banking and financial sectors have demonstrated very serious weaknesses. Almost uniquely in the financial world, the post-trade infrastructures have functioned so far without discernable problems.

Now I am conscious that there is always the risk of making a ‘famous last words’ remark on occasions such as this, so it is important to stress the two words “so far”.

But having said that, I draw comfort – and I hope the industry does too - from the IMF’s recent Global Financial Stability Report.

Nowhere in its 200 or so pages could I find the words ‘post-trade’ or ‘post-trading’, still less the initials CSD, ICSD or CCP.

The ability of the post trade infrastructures to ride out the credit crunch since August last year is rooted in steps taken after the 1987 global stock market crash.

That crisis exposed problems. But it also produced effective responses from the Group of Thirty, which produced a very important report and recommendations in 1989, and the Group of 10 Committee on Payment and Settlement Systems (CPSS) that followed up the G30 report in meetings at the Bank for International Settlements.

Together these bodies put together a coherent programme – centred on Delivery versus Payment in securities settlement - to eliminate risks. Their prescriptions have stood the industry in good stead to this day.

And I wonder if there are not some lessons for Europe in the way the safety agenda was handled then.

To cut a long story short:

- The prescriptions of the G30 and CPSS reflected strong leadership at the time.

- They were framed and implemented in a transatlantic context.

- And they did not run foul of vested interests.

Perhaps these are some lessons to bear in mind as we consider what is needed to create the efficient, low-cost post trade environment that Europe’s economy requires, and which this very important conference is seeking to promote.

Thank you.