OPENING SPEECH

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Deputy Secretary General de Geus,
Dr. Blundell-Wignall and Dr. Vedat Akgiray,
Ladies and gentlemen,

When I was a child in the mid-1960s, my parents took the family east to visit New York, and the New York Stock Exchange was on the program. Nasdaq did not yet exist, so in those days there really was just one glorious financial institution for tourists, the visible beating heart of the nation's economic system; and the NYSE had an open visitor's gallery overlooking the trading floor, which was loud, messy, and turbulent - qualities dear to any boy's heart, and definitely to mine. It was the era of ticker tape parades in Manhattan for returning astronauts and victorious baseball heroes, except that this noise and paper mess at the NYSE was indoors.

Decades later, when I joined the World Federation of Exchanges in 1997, one of my first observations in listening to members was exactly the other way around – what exchanges wanted the outside world to see was not the trading part of the business, which in many financial centers was already computerized, but the list of issuers. There were issuer logos everywhere, indices composed of every nation's finest public corporations. Brochures were at hand to persuade savers that these were destinations worthy of their hard-earned savings. The issuers were then - and always will be - every exchange's beauty parade, the shop window of an exchange full of temptations to get customers inside. That's really rather logical, but then I arrived in the exchange industry in a round-about way from the trading side. Any observation I was going to make was bound to be with fairly innocent eyes.

Before I arrived at WFE in 1997, the Federation had already published its first work on corporate governance. That was in 1994 – some years before the OECD code, which WFE has since come to endorse publicly. The Federation's booklet was entitled "Who Holds the Reins?" referring to the long pieces of leather a driver of a horse cart would have used to steer the horses. That powerful image underscores the physical and mental strength it takes to steer those animals to be sure that the cart and its passengers get safely to their destination – in this case, the public listed company needs to be steered quickly but safely towards its more prosperous future.

The WFE's booklet was written by a committee of experts composed of exchange leaders, jurists from the International Bar Association, and accountants from the International Federation of Accountants. That mix for reflecting deeply about the complex issues of enterprise governance remains the key, as we will surely see in the course of today's review.

I suppose that if I were to go even further into the archives, there would be even older exchange industry work published on governance. I know that at the WFE annual meeting in Amsterdam in 2002, we celebrated the 400th anniversary of the issuance of joint stock securities by the Dutch East Indies Company, which was reckoned to be the first marketable security listed and traded on an exchange in a sense that we would still recognize today. The Amsterdam Stock Exchange had one of those original certificates from its archives on display for delegates.

Exchanges and corporations used to spend a great deal of time engraving, drawing and printing beautiful bond and share certificates, giving something concrete to an investor to hold in his / or her hand that in some manner signified the investment and its potential. They were an image of what the corporate issuer might stand for, a railroad being built, a ship being launched – in the case of a Deutsche mark-denominated municipal bond issued by the city of Munich on my office wall, it was paintings by artists from the local pre-World War I art school, a different artist for each coupon to be presented for payment every six months. And what beautiful works of art they were! Issued in 1995, it paid 6 ½% for five years, a return that would be most enviable today.

My point is that it is hard to render concrete and easily comprehensible something as abstract as investment in securities – hence, for example, the need to keep ringing a bell to open the trading session, even in these days with so few exchange trading floors. This is no doubt even more true since computerization has led to what we call "dematerialization" of securities, which means that no certificates are printed these days. There isn't even a piece of paper to hold in one's hand. It is all down to computer entry, with the contract notes nowadays often sent by e-mail or some other form of "soft copy." This has led to tremendous efficiencies in administering share registries, and no doubt has cleaned up a lot of murky dealings in handing around bearer certificates. Yet whatever the form, an engraved certificate or digitized notation, the money at stake for investors is intangible but real enough.

This brings us to the heart of the exchange role: the joining of investors with entrepreneurs' need for their savings. Step one for an exchange getting down to business after securing its license to operate is the listing process. The WFE Membership Criteria set out the very broad basis for the standard to be met in this regard. I'll note only a few points:

- Listing may or may not be an exchange activity, depending on the jurisdiction.
- Admission to trading generally is a matter for the exchange, and refers to its assigning securities to the most appropriate market segment.
- To be listed or admitted to trading means that the authorities and/or the exchange have vetted the company's prospectus and will monitor disclosure on an on-going basis. It confirms the registration of the issue for the investing public.
- And national listing requirements are often set by public authorities. WFE members should strive to establish their own, higher criteria. This assists in maintaining a high standard for the markets they operate.

WFE's membership criteria continue with encouraging the corporate to prepare its accounts in accordance with International Financial Reporting Standards ("IFRS"), and to have those accounts audited according to the International Standards of Audit ("ISAs"). Exchanges do, rather self-evidently, want access to information on the thousands of issuers of securities to be as broadly comparable as possible across jurisdictions, in order to ease analysis and encourage the flow of investment capital. The OECD's representative on the audit standards advisory board I serve on is a welcome colleague in this work – WFE has served on the advisory board to the International Audit and Assurance Standards Board since 2002, when I volunteered to get involved in the wake of the Enron and WorldCom and Ahold and Parmalat scandals; my colleague from the Johannesburg Stock Exchange now chairs that advisory group. This audit advisory work has been the one "outside" passion that the WFE's board of directors has let me pursue on behalf of exchanges, and quite honestly nothing irritates me more than poor reporting – not just for the investor but also for the authorities, the clients of the entity, the employees, the tax officials, and management itself which can no longer see where it is heading. There are instances when no one is "holding the reins."

With all this, it is fair to say that exchanges understand the absolute commercial necessity of issuers having good governance, in a very broad sense and for many self-reinforcing reasons. Many WFE exchanges have taken the initiative these past years to develop further standards for listing going beyond what has been legally required – often the requirements are set out only in general terms in national company law, so there can be room for detailing them and pushing them upwards. In this regard, too, exchanges have developed specific segments to distinguish among issuers – the blue chips, the best of the best; mid-cap markets; small cap markets or venture markets for smaller and younger enterprises needing access to permanent capital. In these instances, it is made as clear as one can that the investment risks – and their potential returns - will vary as one changes segment.

In addition to segmentation, exchanges, including those represented here at the OECD, have taken the courageous step of noting in red when there are problems perceived with the issuer, and even suspending trading or delisting the security altogether. That's a rather extreme step, because it is inherently hard on those investors who get stuck with that paper in their portfolios. But sometimes it is an unavoidable component of marketplace housekeeping, and because it is extreme it makes for quite a public statement.

So yes, definitely, law and rules and accounting are the necessary bases for good governance of corporate issuers. They will never be sufficient in themselves: when one invests in an enterprise, one is above all buying into management's judgment and sense of responsibility in its execution of commercial anticipations.

While here at the OECD for an exchange forum, it would be wrong not to raise today's most crucial global industry issue, one that profoundly affects the ties between the exchanges and public listed companies. It is coloring the thinking and decision-making of all exchange leaders around the world. Even if the MENA marketplaces remain rather untouched, the problem is affecting everyone at some level or other – it is the matter of fragmentation of the marketplaces, especially affecting the EU and US markets, but also spreading to Canada and Australia, and potentially somewhat in East Asia.

At its origin, I believe, it was thought in regulatory and policy circles in the 1980s and 1990s that competition in its many forms would assure efficiencies in businesses that the government could not achieve on its own through law. During these several decades and well into the one that just ended, the thinking was ultraliberal in the classical economic sense. It colored policy in many economic areas concerning the provision of public goods, very much including regulated exchanges – for we must all remember that fair access to transparent pricing of securities in a regulated marketplace environment with certainty of execution is one of those fundamental social goods. It should be restated here at OECD that the world's regulated exchanges traded through the very difficult environment beginning with the US mortgage market drying up in 2007 – we have a model that has proven itself once again, but which is now terribly under stress for reasons unconnected with the financial crisis whose origins were off-exchange in the OTC markets.

The problem with this ultraliberal competition idea – like any idea taken to an extreme – is that it began with no less than the deconstruction of the exchange business. Trading alone was cut off from the rest of the basket of services which together provide for a sound supervised marketplace: other entrants were allowed to come in and offer trading away from the central marketplace. Any student of life sciences would understand that when studying a live organism, it is best not to begin with amputations – yet the regulatory equivalent of amputation is precisely what has happened to exchanges.

As that has evolved, central market pricing has become impoverished, because orders are being transacted here and there. When an order is internalized or dealt in some banking pool, that trading interest is never shown to the public for another party to react to. Further, it is hard to say that prices of transacting have come down as the authorities in many countries had hoped, because of the extra computer costs charged to connect to so many platforms –something like 60 or 70 each in the US and EU. I do not have an exact count, which demonstrates the extent of the problem, because somewhere in the totals for both marketplaces there appears also to be ample room for securities trading OTC and by internalization. And when it comes to truly counting the costs of establishing a market price in this era of regulator-imposed fragmentation, nothing emphasizes the exchange position better than the "flash crash" of May 6, 2010, when the US national market system in its many parts simply stopped connecting to itself, because of so many different rules applying at once to different kinds of actors.

To return to today's theme, the problem with fragmentation is that when a corporate treasurer wants to know from the exchange what the market interest is in that company's securities, the exchange cannot give clear answers. Surveillance is now incomplete in these marketplaces, and records do not show in their totality who by investor type is trading or investing. This diminishes the value of the public, regulated marketplace for its primary economic purpose, the formation of investment capital as entrepreneurs meet investors. During the "flash crash" in the US, several blue chip share prices fell virtually to zero, without there being any corporate announcements. With the marketplace too blurred for a good read, it is hard for corporate treasurers to estimate further appetite for issuance. At OECD today, we must remember that there is economic value in these prices, and just as crucially there is value in how these prices are formed in the course of trading. We no longer have that second element in large parts of the world.

And sure enough: coincident with the decline in the value of a market price, there is a decline in corporate issuance, in capital formation for the public marketplaces. In last week's *Financial Times*, one article noted that the net capital raised for FTSE 100 companies in London in the last year was just over £ 1 bn, really quite an insignificant fraction of British GDP. If that signal were not enough to alert authorities to the absolute need for market structure review, WFE can underscore the plight of public capital markets with a multi-year view of its heaviest statistic: in 2001, 10 years ago, the market capitalization of listed equities on the member exchanges represented an average of 91% of their GDP, using WFE and IMF figures. By 2009, it had declined to 62%, recovering somewhat with better market conditions last year to 67%. But a fall of 24% in 10 years against the background of a growing global economy demonstrates that the public is not participating in the long-term equity financing of enterprises.

For those in this room who are policy-makers, you will not understand what is on the mind of exchange industry officials everywhere if you do not grasp the urgency of this matter. And it ties directly into the value of being a public company - somewhere in all this there is a massive disincentive to striving for the evident benefits of good governance for issuers of securities. WFE urges OECD to work with it in analyzing the origins of this problem and in proposing solutions.

Thank you for your attention. I very much look forward to today's review, and to the OECD's follow-up in this field in the Middle East North Africa and elsewhere around the world.