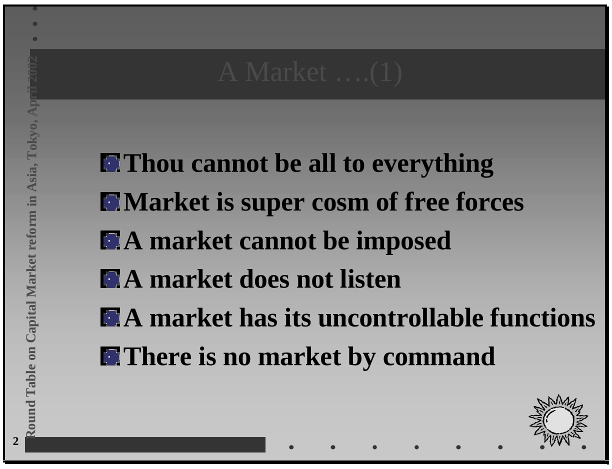
It is a great honour for me to be here in Tokyo again and speaking to the 4th Round Table on Capital Reform in Asia. The last time was in 1999 when we discussed the impact of the Financial Crisis, potential remedies, stability pact and early warning. Today we look back at other crises, but of a totally different kind and origin. We have seen the collapse of the Internet Hype and were confronted with the impact of terrorism. This has resulted in jittery markets.

Today I will address the subject of market structures, a subject that has appeared for along time on the agenda's of exchanges, regulators and their respective organisations and also been subject of conferences, roundtables, etc. Over the last ten years, which represents my professional career in the international capital market environment, I have many times been asked whether real progress has been made to find the ideal structure which would offer all things to all. Well, the answer was - unfortunately - still is: no. I feel that still more convergent work needs to be done, requiring a better concerted action of both markets and regulators.

I have to say at this point that probably a one structure fits all is not realistic either. The reason being that trading is very close to human nature and almost as old as the human itself. Therefore it is deeply embedded in a local culture. Changing that in order to accommodate an new ideal structure is a lot more difficult than customising the existing structure within the parameters of standards and oversight that prevail in the new one.

The main driver to achieve change tomorrow is not regulation, is not philosophy, is not go with the wind, but is shear business and business conditions.



From time to time it is good to remember what we are talking about, what the “root of all evil” is. It is astonishing to see, what we did with the simple economic process of « I buy, You sell ». In a street market it is still simple, you hand the money …. you get the merchandise. Real time clearing & settlement, a dream. Same goes for the vending machine, coin in …. candy bar out. It becomes somewhat more complicated when looking at an art auction. There it is starting to look like the model for exchanges albeit that there is one seller and a whole audience of buyers. The pricing mechanism is loud and clear.

Another phenomenon is the flower auction, which differs from the art one in that pricing is different. For art the bidding goes up and for flowers the bidding goes down. Reason is that the mechanism is much faster. From thereon we see the securities markets going through a development process from call markets, toward continuous markets, with an evolution of determining prices, such as matching, market making, quote driven markets and open order books. Parallel to this exchanges became aware of the typical risks involved with securities markets, such as market risk and above all counter party risk. Actually the discussion and related developments is far from finished.

From the street market to today’s sophisticated markets has been a long and expensive way. The securities markets have developed areas called pre-trade and after-trade having included all kinds of processes that became referred to as « value chain ». The new wisdom is that one cannot efficiently operate a securities market without being able to control the value chain. Mastering the value chain is creating shareholder value. The latter notion is making strong inroads in exchange land as a result of the demutualisation and subsequent going public of market operators. Still the discussion on where C&S needs to reside, either as a wholly owned subsidiary or as a stand alone for profit organisation is not finished. Also notions as Straight Through processing and Central Counter Party solutions are topics that have a high level of priority.

Whatever we achieve in the area of market structures, we never will be able to alter the economic function of a market. The inherent free forces need room to bloom. Regulatory and business processes will have to accompany these forces in order to achieve credible levels of fair and orderly market mechanisms.

Today, the new environment is forcing players to take a different look at the market and its functions. Too much we think that we are able to interfere with basic market principles, but it should be remembered that at the basis of a market lies the price discovery mechanism, the generator of the best price for a transaction. The price discovery element of markets is getting more attention, as the price is the benchmark for series of financial products and for measuring performance for example of asset managers.

Reading the word “discovery” tempts me to say that this relates to the orders that are in search of a price, and not the client that has to scan the worlds exchanges for discovering the best price.

It is relevant for good prices that the mechanism that generates this price does so on a maximum number of orders that it will execute. Fragmentation of a market in separate price discovery mechanisms will be detrimental to the overall quality of the price, typically when no interaction exists between those mechanisms at the moment of pricing. Whilst the notion “floor” has been exiled to a museum, the advantages of a central place for pricing remain understood. The new jargon speaks of “central market system”. Maybe the prime example is the structure of the NYSE, which has fully automated its floor and has been able to compete successfully with all kinds of ATS’s (Alternative Trading Systems) and ECN’s (Electronic Communication Networks).

Even without the traditional monopolies, which was so characteristic for exchanges some years ago, today the importance of liquid and mobile financial markets is so important that the business of operating those markets is good business. This can be judged against the number of new comers, that took advantage of seizing business that the traditional market left unexplored.

Some 10 years ago, nobody would contest the necessity of having a sound capital market as paramount driver for economic growth and welfare. When borders were closed for capital movements, this was true, but limited. Technology brought methodologies that made markets more efficient, but at the same time were driving in new competitors, forcing market operators to review their existence. Deregulation broke the shear monopolies open en allowed for new entrants, new products and new markets. The world became aware of the fact that capital markets, and more specifically securities exchanges ceased to be regarded as public utilities. In looking at the new challenges, the way the markets were organised became under scrutiny. The topic « market structures » was the common denominator for discussions to develop a business out of a traditional monopoly. Notions, normal in other business sectors, such as client satisfaction, business orientation, shareholder value, etc. became topics for conferences and workshops and high on the agenda of exchange management.

The FIBV, now called WFE (World Federation of Exchanges) takes the opportunity to annually poll chairmen of member-exchanges to detect trends in the industry. The results confirm certain « wisdom », but also gives reason to think that a number of unsolved issues remain, typically in the competitive area and in the area of cross border link-ups. One of the subjects of more diffuse answers is the area of alliances. It seems that many exchanges are involved in conversations, but one can follow in the media that not much is happening: a lot of flirting, but no marriage.

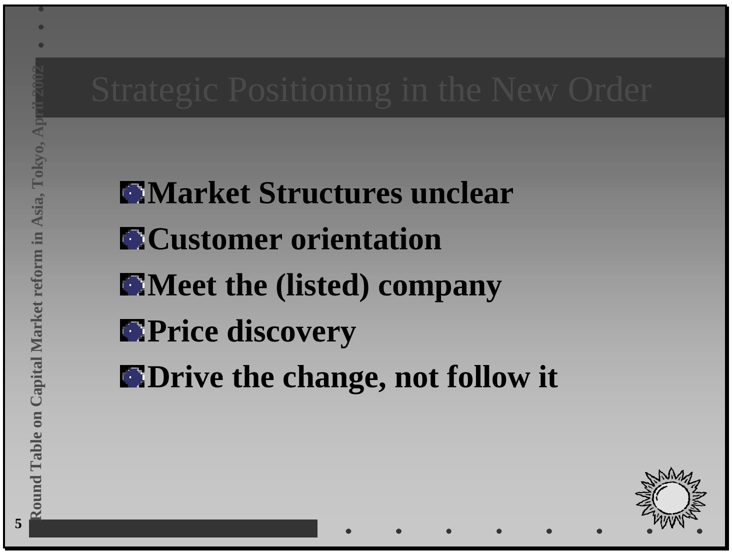
Technology is still top priority when it comes to management attention and budget sizes. Some exchanges have diversified into being also a IT provider. This looks to me as a strategy whereby it is not so much the business of IT provider as stand alone, but more importantly as the tool for creating identical platforms and so paving the path for mergers and acquisitions to expand market share. A typical example is Euronext that markets its NSC trading system aggressively and successfully. Markets that view stepping into the arena of linking markets cross Europe could shorten the integration process by opting for NSC when they have to remake their trading systems.

Other markets prefer independent IT providers, such as EFASoftware from Canada, selecting the specifications that suit their national trading preferences best. To survive in today’s competitive business, IT will remain at the core requiring a constant update and re-evaluation of it efficiency, resulting in marketable trading costs.

It is in my view a logic result of demutualisation and competitive positing that the markets will want to control the pricing toward the end-user (clients). When it concentrates on competitive trading costs, it wants to make sure the client may take advantage of this. In case the advantages of lower cost do not find their way on the contract note to the client, cheaper trading cost will improve the P(rofit) and L(oss) of the intermediary only. When we speak of client orientation/satisfaction, markets need either to convince the intermediary to change his business attitude or do away with the intermediary, allowing clients to deal directly with the market. Of course, issues like creditworthiness, business conduct and fiduciary control need proper attention. But we should realise that certain Alternative Trading Systems already provide direct access and with success. When they seize a business opportunity, this means that traditional markets let slip a business opportunity.

Neglecting the importance of low trading cost will cause big players to start looking into organising an market of their own. The process is referred to as internalising orders, bypassing the central market (system) by an in-house matching of orders. It is clear that when the volumes of internalisation grow, the relevance of the central market price decreases more and more.

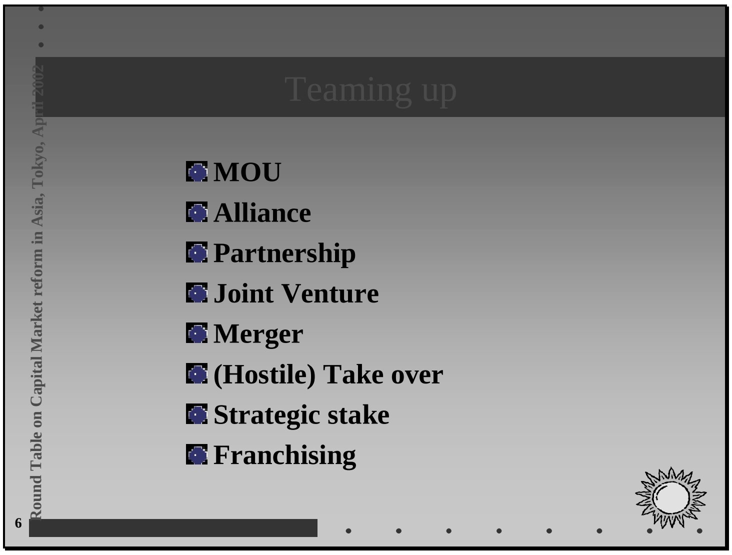
If internalisation remains limited to very large transactions, investor protection issues can probably be ignored: transactors in such size may be expected to look after their own interest. A few investor protection rules should still apply – f.e. principal transactions between a fund or pension manager and a related firm should be heavily monitored - and prohibited in many cases - but in general 'light touch" regulation of permissible off-market transactions is best. In particular, best execution requirements can largely be discarded: if a professional investor wishes to accept a discount or premium to "best price", its interests should not be interfered with. Complete and timely transaction reporting will tend to limit internalisation to precisely those trades that would otherwise have a potential to destabilise markets.



In order to meet the challenges markets started to re-look their governance, ownership, structure and position. The term demutualisation was chosen to make a difference to privatisation, but the result is basically the same. Under the term demutualisation markets went to totally change their being, culture and place in the economic life. It was not only the internal re-engineering, redefining corporate governance and converting into a "normal" business, but also as a result an overhaul of the regulatory system, re-allocation of oversight and redefining end responsibility for making sure that markets remain « fair and orderly ».

One has to say again that the ideal market structure has not been found yet, albeit that a lot of progress in the - what I believe - right direction has been made. The major achievement is probably the continued search for offering higher levels of transparency, typically in the pre-trade sector. Whilst still the issue is quite sensitive, direct access to markets for clients (disintermediation) is coming sooner or later, which has mainly to do with the increased equity culture, the sophistication of the client and technological possibilities.

In redefining their existence quite a few markets ought also to correct their positioning toward the listed companies. Too much one forgets that these are the ones that provide the "raw" material, the tradable financial products. When the new re-allocation of regulatory responsibilities has taken place and the oversight of listing has been switched over to an independent agency or authority, exchanges should take advantage of getting closer to the listed companies and view these as clients for whom a new range of products and services could be developed.



From all of these ways to potentially team up only mergers and acquisitions have been successful. In Europe I have been a witness of 15 years of discussion on what the EU exchanges could do together to provide what was referred to a pan-European market. All experiments ended by failing to have the right business plan, which could have overcome significant political issues.

Today, Euronext can be seen as the first mover, using tools common in company land to expand its market share, i.e. money. Under the leadership of the Paris Bourse Brussels and Amsterdam developed a formula to integrate the three markets. The process is not finished yet, so from an academic point of view it is too early to judge. Other markets seem less successful in positioning themselves in the new competitive arena through teaming up. Other are watchful bystanders, waiting to jump on the bandwagon.

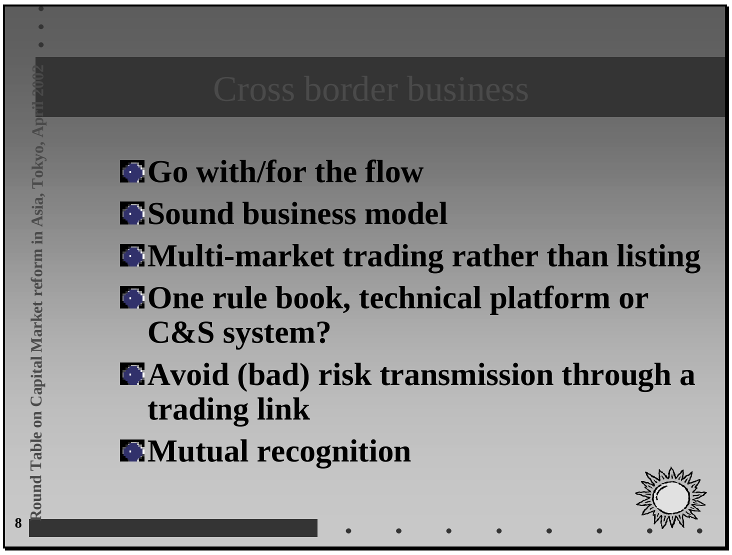
It seems that when the driver for working together is based on business rather than politics, the venture has a good chance to flourish. At this moment not much is happening in the area of alliances. A new one was recently announced here in Asia, spearheaded by the Tokyo Stock Exchange. I am sure the initiative will take advantage of avoiding mistakes made in other regions.

It will be interesting to follow the path, which was set by Euronext, to which today the Lisbon Stock Exchange has been added by way of a merger. Euronext’s take over of LIFFE is even more challenging, when one realises that the common view is that cash and derivatives should ideally be « under one roof ». In the future we may maybe see this achieved when the LSE joins Euronext?

These bullet points picture some of the issues that have to be addressed when looking at a market structure or wanting to change a market structure in order to line up with the politically correct model. It seems that over time each of these issues receive different priorities and from time to time re-arranging of the priorities takes place. Without any doubt, the issue of ownership has been the major driver for change in securities markets and in my view can be seen as the lifesaver for financial markets.

Demutualisation brought business issues to the table, replacing endless discussions driven by vested interests, not typically the same as client's interest. Unfortunately, the supervisors and rulebook makers were relatively slow to follow the demutualisation trend. Even today, markets are well advanced in playing their newly chosen roles, but have to operate under a less clear regulatory umbrella, the final settling down of the dust going only very slowly. In may cases the regulators run against the national legislative forces and sovereignty issues in the cross border environment.

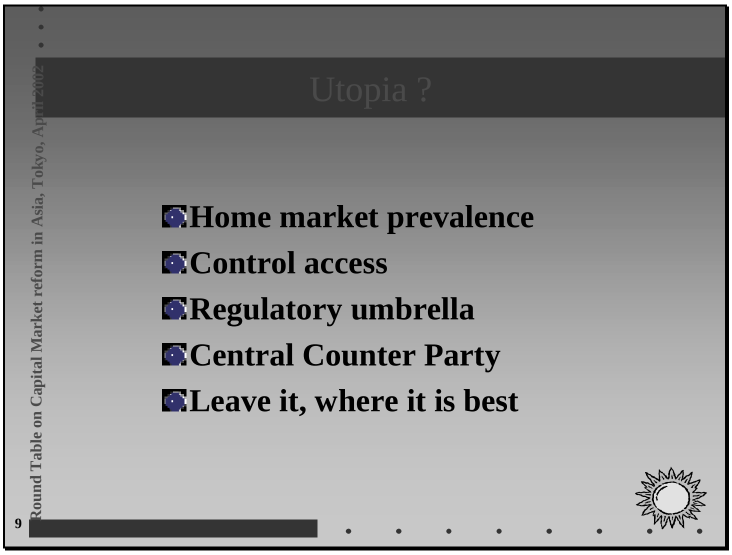
The ideal trading platform is a technical environment which can handle the trading of a diversity of financial products, be these cash, derivative or exotic and support different ways of trading that are inherent to the specification of the traded financial products. In a compacting world of exchanges, convergence toward one trading platform is a long way, but will be achieved by the force of level playing field requirements for clients, both national and international.



A form of working together should bring new business or existing business that can be done more efficiently. All partners need to see economic advantages, which means that cross border traffic should be bi- or omni-directional. A link without traffic has proven to be unsustainable, and we have seen a few of them. Both from an oversight point of view as well as from an access point of view, the ideal market structure for companies that seek access to foreign capital markets should be based on a home market listing (and trading) with only a trading facility in the host market. The home market is best placed to organise and control the transparency obligations of a company to comply with the listing requirements. In that sense, a common rule book with regard to disclosure, transparency, reporting and oversight would not be necessary. Provided of course that the home market complies with international standards, such as set by IOSCO.

In my view, and I have said so may times, proper mutual recognition will be the ultimate driver for a level playing field on which competitive forces will prevail to achieve safe markets for international investment. Mutual recognition is not only for the markets, but also - and probably more difficult to achieve - for the regulators. International bodies such as the WFE and IOSCO should work toward a model for mutual recognition, each setting the standards in their realm and enforcing continued compliance with the standards. Once this is in place members of good standing of these organisations will recognise each other as their peers and accept their regulatory qualifications to be comparable with theirs, making a harmonisation a stale topic in the financial world.

But we are not there yet. However business is requiring speed and efficiency.



The Home Market Concept

Each trade in a security, wherever and whenever traded, follows the trade routines of the home market of the security. This means that such trade settles according to the cycle prevailing at the home market of the stock, the securities remain in its National Securities Depository and the price is established in the currency of the home market, regardless where the trade takes place and by whom[1]. Multiple market official listing might become another financial market museum piece.

This will pinpoint competition to the one and only parameter, i.e. the price of the trade, as generated by the trading system. This de facto the ultimate product of a market. Distracting elements, related to differences in currencies, settlement cycles and systems, etc. will be eliminated and comparison for selecting the best market, will be based on the quote/price only. Competition and accompanying disclosure and reporting will decide ultimately what trading system generates the best price and investors will instruct intermediaries accordingly.

In the extreme case of competition, it could be that an order of an investor in the home country of the securities will be executed at a price as determined in another market. This should give a strong signal to the home market that something is wrong. The result will be a step closer to integration as the endangered market most probably will copy the system that is so successfully competing.

The full advantages of this concept will only be available when securities markets reconsider their market access rules. Strategically this seems contradictory : why would financial markets open their facilities to competitors ?

The argument is that home market for a security, faced with competition that bypasses its price discovery mechanism, can better counter such competition when this can take place on equal ground, i.e. subject to the same regulatory concept. At the same time, business outside the

[1] In other words for an extreme example : A trade in IBM, concluded between a UK trader and an Peruvian broker in Johannesburg, will be done in US$, according to the NYSE settlement provisions, for custody in DTC.

regulated markets will have less reason to develop, when access to the market is facilitated and businesswise affordable.

Competitors, wanting to join the market at the ordering level, theoretically contribute to the size of the order book, thus contributing to a deeper market, resulting in a better price. A more flexible approach to access seems unavoidable : it is better to have the competition in the house than next door. Restricting access to the central system will fragment the price discovery mechanism and thus the quality of the price.

Whilst competition flourishes in bullish markets, the past has brought about that the position of home markets is quite unchallenged in bearish markets. It is the home market, where probably the broadest shareholder base resides, a potential for absorbing selling activity even in bad market conditions. This is also the reason why regulated markets should look for trading structures that offer good prices in all market conditions with a certain continuity. It is the continuity of being able to trade (not at all prices) that in the long run may outweigh incident driven requests for immediacy and liquidity. Hybrid structures, combining order driven and quote driven elements are now becoming of age.

At the end of the day, if such notion exists in global terms, IT might have developed to make available to the investor a screen, offering him the tool to select the stock to invest in and subsequently search the “world” for the best market to trade. The system will offer a "zooming tool" in that the investor can get access to the market(system) with the best price in order to route his order and await execution. Communication technology makes this possible and available at the doorstep.

In this scenario the intermediary has the function of standing before the investor in order to keep the system integer, screening his financial soundness and guaranteeing correct completion of the trade. In fact less an intermediary, but more a risk filter, which may be complementary business when the intermediary position as entry into a markets becomes “passé”.

This integration into a global financial markets offers huge possibilities for economic growth and distribution of wealth, but equally imposes dramatic challenges to the regulator and operator of financial markets. The speed of radiation of bad risk into individual markets is a direct function of the level of integration of systems and controls. Recent "near meltdowns" have increased the awareness of a better coordination, cooperation and communication between regulators themselves, between market operators themselves and between regulators and market operators.

The global integration of markets also calls for a concerted approach in the area of risk management cross border. Indeed recent initiatives have been developed, all aiming to improve supervisory cooperation, avoiding holes in the regulatory footprint as well as improving the efficiency of the regulatory management.

To facilitate asset allocation, worldwide investing and even global trading, the process of risk containment requires a model in which a logical division of regulatory responsibilities is guaranteed. Recent times have indicated the potential systemic risk that may derive from cross border trading when risk can travel freely through the links and affect the regulatory quality and financial integrity of markets.

The strategic challenge for markets will be to generate and attract the largest critical mass as possible to able to compete on the quality of the price discovery with other markets. The access thresholds should be as low as possible, forcing investment decision makers to balance out the total cost of the trade (front office and back office) and the certainty that the trade will settle, i.e. that good money is paid for good stock and vice versa.

In order to manage the cross border risk transmission, linking markets should be accompanied by a system that safeguard the regulatory integrity of each market and subsequently the global system. Home country authorities responsible for supervision should have the powers to gather information from host country players as easy as local players.

Cross border trading could develop safely, when the different risks involved with such trading are absorbed within the market, which is the home environment of each side of the trade. The commercial attraction of routing an order to or within a market will be based on the robustness of its regulatory system, more particularly on the strength of its safety net.

Cross border trading will then flourish, because the risks stay home. The home market is the ultimate actor to assess these risks and take the proper measures and manage these to a near zero level. At the same time it is the best positioned to assess properly the scope of these risks as being close by.

In order to achieve such a new order, a system needs to be developed where the existing safety nets (guarantee systems) can be evaluated. Guidelines, or best practices may be developed to streamline those systems and allow for proper understanding of the system, the scope of the neutralization effect as elaborated above and procedures to invoke the protection. The ultimate goal should be that an investor will only trade in that sphere were he understands the safety net and can be assured that no unexpected risk is transmitted through the cross border link, affecting his trade. On the mirror side, host country authorities determine the level of adequateness of a regulatory biosphere and advise the industry accordingly.

Ultimately, the securities markets, seeing that trading in their stock takes place elsewhere, because of an insufficiently closed biosphere, will start to discuss with the relevant authorities how to improve the system. The drive for better regulation will then come from a commercial perspective, which in many cases may produce a better result.

All parties concerned need to convince the law makers to have more regard for cross border issues when drafting legislation. Unfortunately quite some legislation in the securities industry and company law is lagging behind the recent developments in the internationalization of capital markets. A concerted action is imperative to keep trading cross border as safe and efficient as trading at home.

Lacanau, 15 March 2002

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