



## LIBA'S 2004 ANNUAL REPORT

### STATEMENT BY THE CHAIRMAN

This report covers my last full year as Chairman, to March 2004. As I look back to what now seems to be a tranquil world when this millennium began, I would summarise the changes taking place in public policy which are most relevant to our membership in four ways; quantity; quality; complexity; and international character. Let me begin by saying a little about each.

First, the **quantity** of issues confronting Members continues to grow. There has been no let-up in domestic policy work. The spate of regulatory issues with an EU dimension is unabated. Major changes are now taking place in most securities trading markets. Almost all the foundations of our commercial world are under examination, be it company law, corporate governance, the role of the rating agencies, accounting standards, data protection, or risk management and capital adequacy.

The **quality** is becoming more demanding. Trade associations used to be pre-occupied mainly with a selection of the mundane and relatively technical issues which always concern their members. These could usually be dealt with quietly by expert working groups and contacts with the authorities at a technical level, but the questions under examination today are usually matters of high policy, can have major commercial consequences, or both. Thus adopting capital adequacy proposals for new areas of risk, which could increase the minimum capital needed for securities businesses, could provoke substantial and costly business responses. The enforced separation of the activities of the "integrated securities house" through controls imposed on analysts and research clearly challenges fundamental aspects of the synergies of the dealer-market model which, warts and all, has nonetheless been so successful in the UK and the US for decades.

The **complexity** of developments in the policy landscape increases geometrically with growth in the number of different issues at stake at the same time. So does the incidence of closely related policy initiatives. Thus in the last year, policy on analysts and research for international investment banks in London has had to absorb and respond simultaneously to no fewer than three important consultative documents from the FSA; a set of "Guiding Principles" for fixed interest analysts and research from the Bond Market Association in the USA; an excellent "Forum report" from a group of analysts organised by the European Commission; and the "Statement of Principles", which was adopted by the International Organization of Securities Commissions (IOSCO) without any market consultation whatever. Those who have to handle this welter of controversial proposals are not, of course, officials, but full-time professionals who are trying to run their businesses.

Finally there is the growing **international** nature of policymaking, and its consequences. LIBA and its fellow associations still do much of their business with domestic authorities. But much of this is in response to initiatives which first arose elsewhere in the world or is, today, a direct response to initiative from policymakers both inside and outside the European Union. Issues which could once be dealt with by local telephone calls or a short journey to Whitehall suddenly become the objects of substantial international diplomacy. Where once liaison only had to be maintained with one or two officials or authorities, it is suddenly necessary to monitor the activities of the complex web of European institutions, including the Council of Ministers and its Presidency, the Parliament and its principal committees, the new "Lamfalussy" committees and industry representatives in many other European countries. At the same time, one has to replace or reinforce traditional technical representations with sustained high-level political and diplomatic contacts on matters which, to most people, are mind-numbingly complex and technical, such as pre-trade transparency and internalisation.

I believe that LIBA has continued to acquit itself very well over the year in question despite these challenges. **But in doing so it has relied to a degree which cannot be sustained in the long run on an exceptionally high level of work from its executives, and on the exclusion from the Association's agenda of everything which is not completely essential.** I am sure every Member will recognise that this cannot be responsibly sustained indefinitely. In the end errors will be made, our best experts will choose to move off to less exhausting and better paid jobs elsewhere, and it will not be possible to do justice to some strategic concern. So in a year in which the keynote has always been "more", let me add a few glosses to the substantial reports of our activity which are included, as always, in our Annual Report.

#### Areas of Growth

Historically LIBA has not spent much of its resources on advice from lawyers and other outside professionals, in contrast with a number of other associations. For a variety of reasons, I believe that this state of affairs will have to change at least for the time being. We seem to be in a phase in which the need for legal advice on a variety of issues will increase, whether it be on the significance of competition policy for aspects of trade associations' work, or to provide advice and guidance on FSA rules to our Members.

## **Statistics**

Another important area into which we have now broken is the collection and analysis of strategic commercial statistics. For over a year now, we have been collecting on behalf of our members information about the costs of securities trading; initially in the equities markets but, increasingly, extending to other areas such as exchange-traded derivatives. To do such work to the standard required, whether for sound policymaking and representation, or for discussion with the exchanges and the regulatory authorities, calls for significant and scarce expertise - and extra expenditure.

## **Economic Analysis**

A third area is more conventional economic analysis. As the nature of our policy debates becomes more searching and radical, the questions being posed often turn out to be deep ones. In addition, partly in response to the representations that others have made, policymaking itself is now being undertaken much more systematically, with regulatory impact and cost-benefit analysis and research provided to support it. Thus in the past year, we have had to arrange or publish – often with valuable outside help which I acknowledge later – important economic analysis of the ways in which price transparency, market-making and market efficiency interact and might be modified (and, alas, harmed) by the proposed Investment Services Directive (ISD); and of the consequences of the FSA's proposals for regulating analysts.

## **New Institutions**

The international investment banking and securities industry has to deal not only with new policies but with new institutions, particularly in the European sphere. Once the group of Wise Men chaired by Baron Lamfalussy had had their recommendations adopted, the Internal Market Directorate General of the European Union – as industry representatives had rightly requested – began to set up new structures which we had to monitor and work with. The most notable of these has been the Committee of European Securities Regulators (CESR), which has very properly set up a consultation procedure, supported by new working parties, as the proposals of the Financial Services Action Plan have turned into hard directives. In addition, the last few months have seen the EU add a new dimension to its policymaking consultative apparatus, once again in the spirit of the Lamfalussy recommendations. There is now, in parallel with CESR, a Committee of European Banking Supervisors (CEBS), headquartered in London, whose policymaking activities will be very important for the investment banking and securities sector as well. It has just issued its first three consultative documents, and many more will doubtless follow, particularly as European initiatives in the capital adequacy area pick up momentum.

## **Major Market Developments**

The world of securities trading has historically appeared fairly stable, at least in as much as marketplaces were largely protected and unchanging national monopolies, as were providers of the clearing and settlement infrastructure. Competition of all kinds was confined within parameters which did not change greatly, with the striking exception of Britain's "Big Bang" in 1986 and its earlier American equivalent. The last fifteen months has seen an end to all that. The Stock Exchanges are now private companies and not mutuals, and are not merely flexing their muscles and strengthening their profitability, but are beginning to compete very seriously.

The LSE announced its initiatives to start trading Dutch shares early in 2004, and Euronext has made clear that it intends to respond. The world of clearing and settlement has seen the merger of clearing entities in London and Paris, a welcome development, but one that has focussed attention on the need to find ways of protecting user interests alongside shareholder returns. At the same time, the FSA has been conducting a major review of the Listing Rules for public companies. In parallel with all of this, the EU Prospectus Directive has to be implemented, and other changes are looming with the Takeover and Transparency Directives. This has meant a dramatic upsurge in the work of LIBA Committees, particularly Securities Trading.

## **Major European Policy Developments**

While last year the challenge for market participants in the European sphere was dominated by the completion and agreement of new directives and new policies, the emphasis is now shifting significantly towards the detailed implementation and working out of those directives in 2004 and 2005. There are several directives where implementation is already well down the road – of which that on Prospectuses is perhaps the most notable. There is the enormous subject of capital adequacy, where two new (still draft) directive proposals are imminent, following the very recent agreement of a new Basel Accord. There are major policy initiatives brewing in the area of corporate governance; and there are clear signs of possible initiatives in relation to rating agencies, and investment banking analysts and research. There is a new Money Laundering Directive.

Above all, and most unsettling, there is the implementation of the Investment Services Directive (now known as the Markets in Financial Instruments Directive). This is not the point at which to comment on the unsatisfactory nature of the decisions finally reached by the Council of Ministers at the end of last year, nor on the extraordinary process by which six months were arbitrarily cut off an already tightly constrained

consultation and implementation period. However it must be stressed that the ISD will generate over twenty separate legislative measures, which have to be devised and consulted on at great speed, of which many are extremely technical. Implementation of a substantial number of the most important will involve long and complex critical paths. I doubt the industry has ever had to confront the need to develop as many important policies simultaneously, confronted as it now is by both the ISD and Capital Adequacy on top of everything else.

### **Accounting and Taxation**

Accounting and taxation have, in recent years, been subjects on which conventional consultation and collaboration with other trade associations, the Inland Revenue, Customs and Excise and the authorities have been pursued very effectively. Major and unsettling policy issues have been relatively rare. In one respect this year has seen a consolidation of that trend, particularly as the implementation of the European Savings Tax Directive has wound its way towards an apparently successful conclusion. However there are other areas where new controversy has arisen. Domestically we have faced some radical and challenging proposals about the registration and taxation of "avoidance" proposals. Internationally there has been a heated and still-unresolved debate about the adoption of international accounting standards by the European Union, a controversy in which our members have a double interest. Both as major international players and as the most important intermediaries in the international marketplace, they can see only too clearly the importance and benefits of adopting a coherent international system.

### **International Developments outside the European Union**

International accounting standards are a good example of a major policy initiative which emanates from a non-EU body, in this case the International Accounting Standards Board (IASB). More important still has been the international impact of domestic US developments, often driven by the investigations of the enforcement authorities in New York. For understandable reasons, as the world's financial markets become better integrated and more closely linked, so do regulatory policy developments. The result is not, however, always a happy one for market users. What may begin as almost parochial concerns for the regulators in one area can quickly become a topic of international debate and a stimulus to other regulators to emulate their peer group, be it in the United States or Europe. International securities businesses and their trade associations are therefore faced with still further complications, well illustrated for the first time when the Sarbanes-Oxley measures were rushed through US Congress. So effective promotion of our members' interests in the international markets in London increasingly calls for swift and wide-ranging collaboration with other trade associations outside the European Union, and close attention to the bilateral dialogue between the European Union and the USA, as well as the usual briefing of our own authorities.

The growing role of IOSCO is also important. It is set to exercise a much greater influence on policymaking in future, not least because it is a Forum in which Europe, America, East and West can all combine. Recent initiatives on such matters as analysts and research and its intention to do important work on such matters as Capital Adequacy, Rating Agencies, Corporate Governance, Special Purpose Vehicles and Offshore Financial Centres point clearly to its growing importance. Unfortunately IOSCO does not yet practice the publication of proposals, systematic soliciting of comments from market participants, feedback statements or public debate which have been established – admirably – as the norm in the UK since the creation of the FSA. So we and other market participants need urgently to open up effective channels of consultation and debate with it.

### **The Essential Process of Consultation**

Every year LIBA's Chairman of the day stresses the importance of good consultation, and this year is no exception. With so much happening, and so much of it of a highly technical character, there is no chance of getting good answers, let alone achieving simultaneously international agreement amongst large numbers of very different economies, unless there is thorough consultation over a rational, measured timetable. This lesson is being more widely appreciated than it used to be, and is being much advanced in this country not only by the excellent standards set in the creation and operations of the FSA, but also by the pioneering work of the British Cabinet Office and the Better Regulation Task Force. It is also being assisted progressively by strenuous efforts in some parts of the European Union's institutions, though standards there still have a long way to go. It is also attracting important support in the "Statement on Regulatory and Self-Regulatory Consultation Practices", which was launched recently by the international Council of Securities Associations (ICSA). Adopting good consultation principles and practices of themselves is not, however, enough. If the pace at which new policy has to be made and implemented is unrealistic, no amount of consultation will prevent bad mistakes.

Effective consultation also brings with it certain obligations which it is important to respect, not least inasmuch as analysis or proposals being shared between market and legislators or regulators can be sensitive and confidential. In such cases, it is essential to avoid irresponsible disclosure or publicity. Should that occur, the resulting damage to the consultation process could be out of all proportion to the benefit derived from sharing information with others.

The pace at which the political process has driven policy work forward has long been unrealistic almost wherever one looks. This is, of course, one of the key lessons to emerge from Europe's unrealism over the completion of the Financial Services Action Plan. **We should learn from this experience and not engage in any such hasty initiatives again** – a message tactfully underlined by four different expert groups recently convened by EU Commissioner Bolkestein under the umbrella of his Internal Market Directorate General. The dangers of excessive speed are even greater when almost everything is under radical scrutiny. Big and complex organisations do not flourish when they are in a state of permanent flux and perpetual uncertainty about the long-run framework in which they are required to operate. Politicians and Officials alike underestimate the complexities of simultaneously driving forward a very large, complex, international financial business transacting very large numbers of transactions of very high value with the minimum of risk while, at the same time, redesigning its strategy and organisation, and redeploying a large proportion of its senior staff. The fact that the industry has been able to do this for short periods and has not complained noisily has, perhaps unfortunately, conveyed to the world outside the thought that because such superhuman efforts can succeed, more or less, for short periods, they can be expected as the norm in future. That conclusion is seriously wrong and needs to be challenged and corrected urgently.

### **Relations with Members, Other Associations and Public Bodies**

LIBA's ability both to represent its Members' views, and to bring the best expertise and market experience to bear on them, is greatly helped by the time and efforts committed to our Committees and Working Groups by so many firms and their key staff. This year the contribution has been particularly welcome in the special work we have undertaken on the Investment Services Directive and Exchange Trading costs. But our thanks should go equally to the many others who serve on our Standing Committees and Working Groups; and to David Verey, a member of the Practitioner Panel, and Ian Mullen, Chief Executive of the BBA, who have again participated in our Chairman's Committee.

City law firms have once again provided valuable assistance. Allen & Overy, Mishcon de Reya, and Wilmer, Cutler and Pickering have helped us on particular projects. Clifford Chance, Freshfields, Bruckhaus Deringer and Linklaters have continued to support most constructively the work of the Financial Services and Markets Legislation City Liaison Group, whose work we continue to lead.

Internationally LIBA and its members have added significantly to the many and varied groupings and ad hoc alliances of associations which we co-ordinate or support. We do not always agree with one another, nor do we always persuade the authorities that we are right. But we have already established regular and effective relationships with key policy making institutions, even though our collaborative work is only in its infancy. It is very gratifying that we can find so much common ground with other associations, both inside and outside Europe.

As I prepare to hand over the Chairmanship and reflect on the Association's priorities, I find myself confronted by two or three basic propositions which should, I believe concern every Member.

First, the international nature of our Members' business calls at the very least for a major effort to strengthen and consolidate our co-operation with like-minded firms and associations in Europe and elsewhere. Second, to be effective, such liaisons must preserve the skills, speed of movement and knowledge for which LIBA has deservedly won so strong a reputation. Third, however well we can respond to this international challenge, coping equally with the changes I discussed earlier will require some significant strengthening of our staff, whether to cope with the European Union's new institutions or the ever growing complexity of policy for such crucial matters as capital adequacy, research independence, or securities trading.

Against that background, it was very heartening to learn as we went to press that our director dealing with the ISD, Timothy Baker has been nominated "Lobbyist of the Year" – incidentally the second LIBA Director to win such an award in five years. Part of his particular contribution has been bringing together and co-ordinating an exceptionally effective informal group of like-minded associations to make joint representations to "Europe" on the Directive.

Finally, I am delighted to say that, subject to the final agreement of our Members at our AGM at the end of June, I shall be succeeded as Chairman by Alan Yarrow of Dresdner Kleinwort Wasserstein. The period ahead will probably be marked by some of the most important changes in the Securities Markets and Trading Infrastructure for many years. Alan's dynamic leadership of our Securities Trading Committee and his long experience in these activities therefore mean he is very well equipped to lead LIBA in our Association's next phase.

**David Walker**  
**Chairman**

June, 2004