

# Financial *Innovation*

Bi-monthly newsletter from the Centre for the Study of Financial Innovation Issue no 25 Aug/Sep 2002

## From the director...

Once again, this newsletter is too late and too long – which reflects the fact that there is an awful lot on at the moment. (It has also been written almost entirely by our director of studies, Alexander Evans). Indicative of what we hope to be up to is the review of our latest Advisory Council meeting (held, under the chairmanship of John Plender, on June 11). This endorsed more “rapid reaction” meetings (such as the one we organized on the impact of the conflict over Kashmir) and suggested we might also look at *post mortems* of issues (eg. Enron) that have been in the public eye for some time. Thoughts please.

Among the topics for further work, several stand out:

- We will have to focus on terrorism and related issues – particularly as the anniversary of September 11 approaches. Just what has been done in the areas of disaster planning, business continuity, terrorism insurance etc.? And what are the US, IMF, FATF etc doing on the money laundering/terrorism finance side? I think we also shouldn't avoid some of the macroeconomic issues raised recently by the OECD in its report on the (adverse) economic impact of the crackdown on suspected terrorism; inevitably, trade will become more expensive and labour mobility more limited.
- We haven't given enough thought recently to Europe. There are real concerns, not only that the Financial Services Action Plan is lagging, but that in some areas it may actually prove to be disadvantageous to UK financial institutions. This is a contentious area, but there are legitimate grounds for watching closely how directives in, say, the e-commerce area work – not to mention the continuing controversy over the prospectus directive. The Centre needs a bit of a kicking in the direction of Brussels. After all, the euro could come a lot faster than the City currently seems to be expecting.
- Corporate governance used to be the City's alternative to novocaine – but Enron, WorldCom, Tyco, GlobalCrossing etc etc have changed that. We hope to have a paper on some of the key governance issues out soon (by Monks and Sykes), but we will also need to look again at the GAAP/IAS debate, the role of remuneration consultants, perhaps even whether actuaries shouldn't suffer some of the same criticisms presently being directed at auditors.
- Given the growing concern about rules-based microregulation in the financial sector, there is strong support for looking (perhaps on a regular basis) at the competitiveness of the City – both over time and *vis-a-vis* its major international competitors. Given resource constraints, this probably couldn't be more than a fairly impressionistic survey (modelled on *Banking Banana Skins?*), but it might be useful as a way of capturing a worry that at the moment is pervasive but ill-defined.
- Linked to this is the legitimate question “Who speaks for the City?”. We are currently finalizing a fairly detailed study of financial trade associations (of which there are around 60, with an annual turnover of more than £150 million) – but, rather than answering the question, this has just made it more pressing.
- Clearly, one cannot ignore the pensions issue. The UK leads in this area by dint of having recognized the problem earlier, but the US is catching up as employees watch their 401(k) plans wither. Just how are we going

*Continued on back page .../*

## Forthcoming Diary Dates Round Tables

### October 15

Rethinking the Consumer Credit Act A round-table discussion with (*inter alia*) Jonathan Rees (DTI), Penny Boys (OFT) and Martin Hall (FLA).

### September 5

The independence of equity analysts: A round-table with Roger Bootle (Capital Economics), John Plender (FT) and others.

### Date to be confirmed

Financial inclusion: A round-table with key players in the financial inclusion debate.

Please be advised that all dates are preliminary until invitations are sent out. Our web-site ([www.csfi.org.uk](http://www.csfi.org.uk)) carries the latest schedule.

**CSFI**  
Centre for the Study of  
Financial Innovation

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## Trading Risk: A new proposal for trading predetermined levels of risk.

A round-table discussion with Michael Hyman ( Global Financial Risk Solutions). April 22, 2002.

It is time for the next generation of risk management models – so says Michael Hyman, a bright American who has been thinking about a fresh product wrinkle that could ‘export’ in-house risk. He argues that multinationals spend a fortune each year hedging currency risks, often losing out in the process. More worrying is the fact that many multinationals do not manage their currency risk exposure at all well. This ought to come as no surprise. After all, companies like Ford spend around US \$150 bn annually buying components overseas – yet only hedge some US \$53 bn of it.

For a while companies have been encouraged to focus on their core business – and that supports the argument that non-core risks should be packaged off wherever possible. But how? For sure, multinationals can play at managing their risks through the capital markets, but this requires expertise. Ought a car manufacturer really be dealing in baskets of currencies? Or should there be a way in which specific types of risk can be packaged and sold off, ideally as a limited insurance product? Hyman argues that capital markets deregulation has opened up fresh ways of bundling risk, creating products – tranches of risk – that can be bought, sold and managed just like other market products. For businesses seeking to minimise their exposure, the appeal lies in outsourcing medium-term default and counterparty risks, as well as long-term contracts and systems risk. Essentially, he is proposing an overlay contract that protects multinationals against volatility in the currency markets. The variable and arbitrary costs of managing currency risk can be translated into fixed insurance costs, with the insurance markets providing a backstop.

Hyman’s proposal earned a cautious welcome from fellow participants. The suggestion that his scheme would make non-tradable currencies effectively tradable was appealing. Some wondered whether the proposal might be designed to hedge against overtrading – a perennial risk for business treasurers, when faced with financial risk exposure.

There are barriers. Globalisation remains young, deregulation variable across the world, and historically, the gulf between insurance and capital markets has been tough to cross. But Hyman is optimistic that his pitch for layered tranches of risk exposure to be sold to the markets can work. Indeed, he argues that it doesn’t have to be limited to a single company – weighted average slabs of risk drawn from different firms could be bundled and traded, potentially creating a fresh market. (This helped assuage fears that outsourcing these risks would be like putting a company’s entrails on display. Risk slabs could simply be categorised by the credit rating of the issuing company.) Hyman is continuing to try to pitch his idea – and he hopes to press forward with some of Ford’s risk in late 2002. AE

## The impact of the Internet on European securities markets:

A joint-meeting of the CSFI and the Financial Internet Working Group, with Charles Goldfinger (FIWG). April 23, 2002.

How do we get from integration to interconnection? There is a lot still to do if European securities markets are to link up with each other, rationalise, and cut their (excessive?) costs. Charles Goldfinger and the FIWG have been toiling away at our expense, thanks to the EU, trying to figure out what is going on now – and what shape the market ought to assume. Goldfinger remains remarkably positive about the impact of the Internet. We are going to have a ‘cyberbang’, he asserts, despite the lacklustre volumes of e-broking today. Given the price of clearing and settlement, there is scope for cutting costs through technology. Yet major reviews of the future of financial services in Europe – like the Lamfalussy report – appear almost technology-blind, making scant reference to the impact of the Internet and associated innovations.

In part, argues Goldfinger, securities trading is like mobile telephony. It is not a fully open, competitive market – and nor, perhaps, should it be. But there is good reason, not least the drive to make Europe competitive in a global arena, to reduce waste in the system. There are some signs that the Internet is advancing, however slowly. Bond trading does appear to be migrating on-line. But more needs to be done – and EU policymakers have a special responsibility to drive things forward. Easier said than done: this policy area falls between Commission directorates, sometimes coming under the internal market, sometimes technology. Achieving a purposeful, consistent agenda will not be easy.

Interoperability is one solution. Even with monopoly providers, regulatory insistence on interoperability opens up the market and provides competitive space within it. This is what the SEC is doing in the US. Even so, the outlook for change is mixed – as Goldfinger himself admits. While the EU wants to push competition, individual member countries are keen to protect their regulatory territory. Member states are loth to give up their legal rights, and the logic of a pan-European regulator (Goldfinger’s preference) comes up against the hard realities of how Europe works.

Further criticisms of the industry as it stands were aired: it was pointed out that Swift determines the standards for interconnectivity, and it comes as little surprise that these standards are not XML compliant. System can speak unto system, but the language will always be Swift’s. A bandwidth charging system might make more sense, but Swift benefits from \$1 a message now. Bandwidth-charging would hit Swift where it hurts.

The FIWG draft report is an interesting document (and available from [www.fininter.com](http://www.fininter.com)), but will it make a difference? It charts what exists now, and doesn’t tackle head-on the blockages in the current system – or name those who benefit from the blockages. It is up to the Commission – and industry – as to what happens next. AE

## The current environment for microfinance:

A round-table discussion with Sam Daley-Harris (Director of the Microcredit Summit Campaign). May 1, 2002.

Does microfinance liberate new money for development? Can it distribute existing funds more efficiently? It's not enough to be nice; microfinance has to sell itself effectively. Those of a pro-market orientation used to think that the new money that flowed into microfinance could, in effect, create a separate sustainable asset class. That way, perhaps, it could drive fresh funds into development. The world didn't end up like that (apart from isolated successes like Peru). But even cynics must concede that microfinance is a highly efficient way of distributing existing development money more effectively.



Sam Daley-Harris

The 1990s was a decade of UN Summits, with (in 1997) the Microcredit Summit organised by Sam Daley-Harris in Washington DC. This preached the micro-credit message, arguing that here was a vehicle to reach the poorest, empower women, build institutions and deliver measurable impacts. But reaching the poorest is easier said than done: getting finance to the poorest 20 percent is perhaps the hardest task of all. Conventional wisdom suggests that the poor are too costly to identify and motivate. But, with a suitable tool-kit, Daley-Harris insists they can be helped to help themselves. With micro-finance, you can build self-sufficient institutions for the poorest (and run by the poorest). Today, more than 19m of the poorest households worldwide have access to microfinance services. But the Microcredit Summit Campaign's target of reaching 100m households still leaves a lot of ground to be covered.

The MSC has more than 2,000 members, covering some of the poorest people on earth. The next meeting will be in Mexico in November 2005, once again sharing best practice in the search for minimum cost, maximum impact microfinance initiatives. As ever, microfinance institutions need equity – particularly if they are to grow as Daley-Harris wants them to. Aid agencies can provide some of the necessary funds, but private equity is unlikely to follow. Where will the remaining investment come from? AE/AH

## The changing the shape of pension assets: FRS17 and all that.

A round-table on the implications of FRS 17, with John Ralfe (Boots), Sir John Craven (Lonmin), Graham Bishop (Grahambishop.com), and Allan Martin. May 1, 2002.

John Ralfe has made a name for himself as finance director of Boots plc, where he took the bold step of shifting its pension fund assets into (primarily supranational) bonds. Speaking in a personal capacity, he explained why Boots made this shift – and whether it (and similar decisions be-

ing driven by FRS17 and falling markets) suggests that the cult of the equity is dead. As he put it, holding equities to pay pensioners is a straight bet, just like the 3pm at Haydock.



John Ralfe

Boots took the steps it did to reduce pension risk – as much for the 72,000 members of its pension scheme as for the company itself. As a result, there have been huge savings in management costs – and a resulting buyback of Boots shares. The driver for the decision to shift was falling equity markets allied to rising pension liabilities. The FTSE is the same now as it was five years ago – and more than 25 percent off its peak. Finance directors, trustees, actuaries and fund managers are all afraid – and as a result we're seeing a major period of transition.

The Boots model won't apply to everyone: different companies will opt for different mixtures of equities and fixed-income instruments. But the present model is unlikely to endure. Companies, some more quietly than others, are adjusting their portfolios accordingly. This will have an impact: as pension schemes shift into bonds, the bond market will rise, while equities will be hit further. Many companies will have to increase their contributions. Will the US be forced to follow suit?

Allan Martin (latterly of PwC) explained that low inflation, lower returns, and increased longevity determined the changes that we're seeing. FRS17 simply tells the truth – even if, sometimes, we don't much like what we hear. Pension risks are huge, but even now, are not heading the corporate governance agenda. John Craven suggested that there is a major public policy question to address: where might changes in the UK leave us in the global economy; if Germany (and others) continue blithely to go for unfunded pensions? Graham Bishop felt that the MFR would be pushed towards a bond-based system. And there still lurks a central question: given ever-growing demand for bonds, where will they come from? Could the (huge) UK mortgage market be used to provide a supply? AE

## Improving transaction processing using open distributed technology:

A round-table discussion with Kathleen Tyson-Quah (Granularity) and Rudi Bogni (Medinvest). May 9, 2002.

Legacy systems cannot, and do not, talk to each other. What we need is an open technology framework (XML based) that can offer remote risk management based on real information. With her thinking cap on, Kathleen Tyson-Quah came up with just that model in under six weeks. Running real and historic data, it can deal with snafus present in today's capital market infrastructures. These infrastructures are, she argues, the last bastion of Soviet-style central planning. One size fits all,



Rudi Bogni

these mutually (or privately) owned behemoths define the common good (and fight to keep it just so).

The Internet can democratise product and service provision in the finance sector. There have been notable hits – for example, Eurobanking EBS/FXNET, which created a new market. There have also been cold turkeys, like Taurus and Cedel. The hits have in common the fact that they were taking on inefficient monopolies, leveraging data standards or creating new ones. The misses tend to perpetuate existing technology, or were products themselves of central planning – a fault that plagues new initiatives like CLS, Bolero, Identrus and GSTPA.

Rudi Bogni observed that trading operations people used to be bottom of the totem pole in banking. That has changed, but the pan-industry utilities that exist are disappointing at best. Succumbing to a psychosis of security, we cradle existing systems, learning to live with their (many) defects. Why should the future be any different? Payments systems consume 0.4-0.6 percent of a country's GDP. In the US, roughly \$40 per person, in the UK, about €5 each. This is a steep bill, and damages the economy. Global banks save €130m for each one percent improvement in STP. This could be passed on to customers – and help banks make more from less.

One central message came through: data standards and messaging syntax are not irrelevant details, but the challenge in reaching integrated, efficient capital markets. (Some claim that the bottleneck is Swift, an old-style vendor and standard setter.)

AE

## Banking Banana Skins 2002:

A round-table discussion with David Lascelles (CSFI), David Green (FSA), John Hitchins (PwC), and Michael Green (Lloyds TSB). May 20, 2002.

David Lascelles introduced the CSFI's hardy perennial, commenting briefly on what has changed. The list of bankers' concerns used to focus on technology, but now it has shifted decisively to reflect the present operating environment. Given the poor market, strategic issues have taken second place to concerns about credit risk and other operational matters. There are fresh concerns around business continuity and insurance (prompted by September 11).

Worries about over-regulation have clearly increased – although this may be, in part, due to the shock of change. Whereas domestic regulation raises hackles, it's the absence (or ineffective nature) of international regulation that also makes City bankers sleep less soundly at night. Finally, *Banana Skins 2002* came out just as the AIB scandal broke. This appeared to belie the low ranking of rogue trader risk. Perhaps it makes sense to turn the list on its head; after all, what bankers worry about least will probably leap up and bite them.



David Green

John Hitchins suggested that credit risk always ought to be at the top of the list: as it is in 2002. It is telling that we're two generations (in City terms) away from the last downturn. Regulation – over, rather than under – is the big concern. Money-laundering (in at number 11) also comes under regulation. Basel 2 is a banana skin in its own right – are overseas regulators of sufficient calibre to administer Basel 2-compliant regimes? The combination of Basel 2, international accounting standards and the euro (all at the same time) is tying up systems development, and forcing IT to change. Other risks are growing thanks to the increasing complexity of financial services. Legal risks are amplified by complexity. What's missing from *BBS 2002*? Strategic issues – and if a single institution goes off the rails as a result, the pressure for short-term growth could lead to disaster.

David Green liked the fact that *BBS 2002* can now be set against earlier studies, offering a brief picture of how risk perceptions have changed over time. While anecdotal, *BBS* is useful – although it would be interesting to go back and examine some of the dogs that didn't bark. A lot of effort went into stopping Y2K from posing a major threat – and is it worth picking on (similar) Banana Skins past to assess how Banana Skins present sit? Some *BBS 2002* risks have leapt up the table (like Basel 2, N2, and 'Know your customer'). Misperception can however creep in, for example, on N2, where the market desire for a single rulebook now means managers must take greater responsibility. There are real changes going on in the market – which adds to the pressure on regulators. Yet regulators see falling budgets (in real terms) and there isn't the clear link between risk and remuneration that exists in the private sector.

For Michael Green, reputational risk matters hugely – particularly now. Post-Andersen, there is a realisation that reputations can destroy companies. Other risks persist (rogue traders, regulation – where there is a lack of trust – Basel 2, and emerging markets). And credit risk, even without a recession, is critical. *Banana Skins* remains a popular report – and David is planning another survey, probably early next year.

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## “Harvesting technology: Financing technology-based SMEs in the UK.”

A round table discussion on the recent CSFI/DTI report with Craig Pickering (FLA), Lucius Cary (Seed Capital), and David Beer (Beer & Partners). May 21, 2002.

Our recent CSFI report on SME finance, *Harvesting Technology*, was launched by the author, Craig Pickering, on May 21. The venue was grander than usual – the Royal Society – but the thrust of the debate was as robust as ever. Craig's report covers work done by various official and semi-official reviews since 1996, picking up on what has been done – and what could still usefully be done. His initial focus was on achievements:

- UK business angels are growing;
- Britain remains a prime market for private equity – although not early stage capital;
- our incubators are healthy;

- SMEs enjoy decent tax breaks; and
- while there are complaints about over-regulation, only a few issues (like the draft EU prospectus directive) raise hackles.

But gaps exist in this rosy picture. Early stage funding in the UK falls far short of the amounts invested in the US. There is less corporate venturing around than there should be. Universities, despite all those polled in a BoE study reporting they had technology officers, still present bureaucratic hurdles to entrepreneurs. The professions remain conservative, the Internet is (still) not being used enough, and too much venture capital follows the rest of the herd. Clearly, more still needs to be done. *Harvesting Technology* suggests:

- more academic research into early stage finance;
- studies on how to get companies ‘investment ready’;
- further work on investor relations;
- better use of the Net;
- research on why Germany appears to get it right, with more venture capital available;
- opening up tax incentives once more for corporate venturers;
- light touch regulation for smaller exchanges; and
- a national framework for University policy on entrepreneurship and spinoffs, while protecting their independence.

David Beer welcomed the report, and insisted that the non-technology sector suffers from similar problems. He suggested that while much appeared to be going on in the public sector, it was a bit like elephant sex (lots of noise, but nothing happens for months). Regulation remains a problem, and perhaps the sector needs an ‘idiot’s guide’ to provide a pathway through the complexity. Beer also suggested that the DTI looks at what public education there is for those who want to invest, but need to learn how. Lucius Cary also supported the report, but suggested that the government was putting in a lot of effort (EIS and Smart are splendid, VCTs a wonderful ‘tax bribe’). Further tax incentives for investors would be good, particularly as a revised capital gains tax regime has helped to knock VCT investment from £450m last year down to £125m in the year to date.

The discussion revolved around the report’s main findings, but also saw mentoring get an honourable mention - and a brief dispute over the (true) value of advisers. Do small firms hunting capital get their money’s worth from advisers, or are they fleeced for what usually turns out to be nothing? A lot of worthy issues came up; evidently, the CSFI should continue to watch the early stage finance area closely. AE

## The City and academia:

A round-table discussion on links between the financial services sector and UK universities with Esther Wilkinson (EPSRC), Tim Sheldon (Institute of Actuaries), David Hand (Imperial College), Con Keating (Financial Development Centre) & Thymis Carolides (Alektor Investment Management). May 23, 2002.

There continues to be precious little demand for university-led academic research from the City. This was the message

from this round-table, sponsored by the Engineering and Physical Sciences Research Council (EPSRC). Its gloomy prognosis echoes the CSFI report, *Quant and Mammon*, published in April 1999. Back then David Lascelles, its author, concluded that the market for academic research among banks was limited, with UK banks only spending some £1-2m a year on direct academic programmes. (Of course, a wider range of individual consultancy arrangements exists, but even so, the total volume of bank spending on academics is derisively low.) This is still the case now. As one City fund manager put it, when a bank needs an academic, it can hire a bright young PhD and put him/her on staff – it doesn’t want (or need) to invest in an institutional relationship with a university.

This is not unreasonable. There is a difference between what banks want, and what academics do. Academic research is a gamble. Bankers don’t want a white knuckle ride; they want to know the benefits that will accrue from research. Most bankers really want a piece of management consultancy. They want someone to come in, define their problem explicitly, cost solutions, and determine how long suggested solutions will take to implement. As *Quant and Mammon* explained, banks prefer tools and applications to blue-sky speculation.

Moreover, academics are academic, and hence (at least in part) inclined to be commercially oblivious. Nevertheless, while academia and banking may be worlds apart, there are complementary strengths. The universities can offer long-term research to the financial sector. According to David Hand, a professor at UCL, this research does have an impact. Just as twenty years ago a revolution took place in investment banking thanks to quantitative finance, a number of innovative changes are taking place in other fields of finance thanks to academic research already underway.

Perhaps the gulf between academia and finance is down to what banks want. In most cases, they are not after a new theorem or economic model. Banking institutions seek strategy advice: and this is better served by consultancy firms. Consultancy firms are better placed to deliver the right mixture of research, politics, and business planning - in a lucid, useful form – than their academic counterparts. And consultancies are more likely to deliver on time, to a spec that suits the institution. While institutions might go to a business school for the design of a new instrument, they will tend to go to the management consultants for advice on how to use it.

Will anything change? Bankers think not: one said the relationship with the City hasn’t changed, won’t change, and shouldn’t change. According to the EPSRC, industry can help by getting involved in academia. Through research councils, industry can engage in strategic partnerships with academic institutions, co-venturing on relevant projects. But bankers can also participate individually, for example, by offering to peer review research proposals or papers. Most financial institutions, of course, are motivated by the earning potential from exploiting high-quality research. At the end of the day, City institutions may prefer to hire a PhD than sponsor a university chair – or directly engage academics on (lucrative) consultancy contracts.

Within the (small) banking market that does exist for academic research, the challenge now is to identify specific and useful ways in which to draw on the advantages that academics offer. AE

## The annuity problem:

A round-table discussion on retirement provision, with Dame Sheila McKechnie (Consumers' Association) and Dr Oonagh McDonald. May 27, 2002.

Annuities are rotten value as an investment product, and mandatory purchase of annuities at a set age is a rotten way to force retirees to fend for themselves. This was the basis for (another) look at the annuities problem. For while many of us want to be shot of compulsory annuities (or at least ease the compulsion a little further up the mortality scale), better answers to some of



Sheila McKechnie

problems thrown up by (lengthening) mortality and longer retirements just don't seem to be emerging. Right now, in the UK, compulsion kicks in at the age of 75, when we all have to purchase an annuity. This is three to four years short of the (present) average male lifespan. The second report of the working party chaired by Oonagh McDonald, *Extending Retirement Choices*, continues to recommend annuities. However, it argues that the annuity should only have to guarantee a minimum retirement income.

What are the issues from the consumer perspective? Sheila McKechnie (who promised a CA report in the issue later on in 2002) argued for basic principles:

- a minimum income for all those in retirement;
- funded access to health and long-term care;
- provision against a retreating welfare state; and
- asking whether private financial services can be made "fit for purpose"?

Consumers find compulsory annuities vexing. They don't understand the tax driver. They find annuities, on top of endowment policies, baffling. All in all, there is consumer detriment – through poor rates, indifferent products, and continuing compulsion. From a public policy point of view, retirement patterns are unpredictable. Some pensioners like to put their feet up; others dash around the world in a second childhood. There are three main groups of retirees, who are:

- too poor (and who need a helping hand from the state);
- too rich/clever (who can stand on their own two feet); and
- the middle-classes, who are grappling with the shift from public to private provision.

It doesn't help that 25 percent of men reach 90, and 24 percent of women will reach 94. Add a wave of early retirements, and the scale of the problem is self-evident. The market for annuities will grow massively over the next 25 years – but where will the fixed-income instruments come from that can provide? The market needs a shake-up.

Consumers are like sheep in the face of providers who, once they have you, have you for good.

McDonald argued that product regulation is the biggest challenge. The state cannot be turned back to, but the market has to be more flexible in what it offers to retirees. It's also ironic that the poor subsidise the rich here, as the poor die more quickly. Those with public pensions will do better than those without. So where are the solutions? An open market, in which consumers could shop around, would help. Products might become more competitive, and the 10 percent expense ratio (rightly attacked by John Chown) could fall. But floundering equity markets, and rising demand for fixed-income instruments, continue to beg the question as to what products will backstop annuities in the future? AE

## Watch South Asia: What will the current Indo-Pak conflict do to the markets?

A "rapid response" round-table discussion on the Indo-Pak crisis, with Victoria Schofield, Thomas Withington (Centre for Defence Studies, King's College London) and Alexander Evans (CSFI and King's College London). May 27, 2002.

This was something of a departure for the Centre. We had discussed the possibility of putting on 'rapid response' round-tables, designed to pick up explosive topics quickly. The idea attracted support; it seemed logical enough to pick on the Indo-Pak crisis in May as the first of these. There were clear market implications (the crisis had hit regional markets, and boosted the gold price), and the possibility – however remote – of a South Asian nuclear exchange put the region firmly on the map.

Victoria Schofield, author of two books on Kashmir and freshly returned from the region, introduced the Kashmir dispute. The crisis is over a chunk of real estate, Kashmir, and a bundle of wider issues – including Pakistani support to anti-Indian militants in Kashmir. New Delhi held Pakistan responsible for groups involved in major attacks, including a suicide attack on the Indian parliament on December 14. This led to a crisis between India and Pakistan, with India ominously close to war at the end of 2001. Pakistan, under US pressure, backed off, promising to rein in the militants. But has the promise been kept? As further attacks took place in Indian Kashmir in April 2002, New Delhi once again blamed Pakistan – moving further military divisions to the border, and sending warships into the Persian Gulf. The diplomatic message was clear: either Pakistan took further steps to clamp down on militant groups, or India reserved the right (like the US post September 11) to take all necessary steps.

The threat of war was there – but would it be all-out? Thomas Withington, a defence specialist, thought not. India's military options are limited, but the ambiguity lay in how Pakistan might respond. Islamabad's rhetoric had encompassed the right to respond to an attack with nuclear weapons, but how much of this was bluff? As Withington

chillingly set out, any nuclear use would be disastrous, with a human toll vastly in excess of Hiroshima and Nagasaki. And as India and Pakistan are so close together, a nuclear exchange would impact both countries, even if only one side used its devices.

So what of the economic fallout? Alexander Evans, who wears a second hat as a Kashmir specialist at the Centre for Defence Studies, King's College London, argued it would be limited. Regional stock exchanges took a tumble in May, with nearly 10 percent wiped off Mumbai, and intermittent closures of Karachi's exchange. A deeper impact was felt on foreign direct investment. While Pakistan and Kashmir have little to offer to foreign investors, India has attracted funds since liberalising in 1991. But since December's crisis, investment decisions have been delayed, and India's software industry is hurting. Globally, the impact of the South Asian crisis was minimal – analysts and brokers were agitated, but more because of the perceived high risk of a nuclear exchange. Most analysts in the region were sanguine – even if armed conflict broke out, they argued, it would be contained before going nuclear.

A few days after the round-table, tensions defused, in part thanks to behind-the-scenes activity by the US. But India has not yet pulled its army back from the border, and another militant attack in early June saw global markets wobble. There is still scope for conflict, and until a major settlement is arrived at (which may be years in coming), instability will dog the region. This could be amplified by further shocks (for example, an attack on an economic target, like the Mumbai Stock Exchange). If a nuclear exchange did take place, it could shock the global economy into deep recession, but while nuclear scenarios appeal to tabloid journalists and gloomy market-watchers, specialists argue that the risk of nuclear use is low – even if the possibility of accidental use (or a nuclear accident) remains relatively high.

The biggest victim will be the economies of India and Pakistan; as investor confidence ebbs away, India's claim to be the software and outsourcing destination of choice appears less persuasive. In late June, a delegation of Indian industrialists set out to the US to try to persuade investors India was safe to work with. It may take a few more months – and further military de-escalation – for the markets to be convinced.

We plan similar rapid response round-tables in the future: thoughts and suggestions as to what kind of crises we ought to respond to, and how we should field a response, would be appreciated. AE

## The future of financial advice in a post-polarisation marketplace:

The first meeting of a CSFI working group (supported by Accenture), with Stuart Fowler. June 11, 2002.

This was a useful group put together in the aftermath of concerns over the FSA's CP121 proposals. Sponsored by Accenture (represented by Pauline Wood), the group aimed to inform a report that would be written by Stuart Fowler.

What will shape the financial advice sector over the next five years? Should (and can) products be revised? How can

technology be used more creatively? And how can we rethink regulation to achieve a lighter and defter touch? Fowler made it clear that the focus should be on reducing the cost of advice – whether that advice comes as part of a product wrapper or whether it is provided separately (on a tied or independent basis). Most of the reasons for cutting costs are obvious, but one is less so: according to him, one of the results of high initial and continuing costs is that clients are sucked into taking on inappropriately high levels of risk.



Stuart Fowler

How can more money be saved (and we all need to save a lot more)? Fowler sees two possibilities:

- simplifying the tax system for savings and pensions (a point he has made several times is that, for lower income groups on benefit, a "poverty trap" operates – perversely shutting them out from state benefits if they actually make savings provision); and
- creating a low-cost distribution system, probably technology-based (though, elsewhere, he has spoken approvingly of how his father was able to buy gilts through the Post Office).

There was general agreement that the report should go well beyond CP121. Wood claimed that she has identified 23 separate reports or reviews either underway or recently completed in this general area - of which Sandler and Pickering are merely the two best-known. The problem is (as she put it) that there is so much going on that one cannot get a sense of what is *really* going on. At the least, we need to be aware of what initiatives are underway – and why. The emphasis should be on the "post-polarisation" environment (albeit incorporating the other reviews, as well as CP121).

One of the particular fears raised by the group was that the changes initiated by the government (CAT-marking, CP121 etc) – all of which are aimed (directly or indirectly) at cutting the cost of advice – will end up undermining the economics of providing advice just at the time it is most needed. Other issues considered included:

- the impact of prolonged low inflation;
- the role of home ownership;
- the availability of workplace advice;
- technology and market segmentation; and
- product suitability (which AH thought could be dealt with by treating simple and well understood products as saleable "off prescription" to any consenting adult, while others – more complex, newer or more likely to blow up – would only be available "on-prescription", ie following receipt of advice from a professional).

Already, it is worth pointing out, many savings and investment products (from current accounts, to National Savings bonds to 30-year mortgages) are already effectively off-prescription, so we understand the principle. The group ended up with a set of questions that would inform the second meeting - a summary of which is provided below. AE

## Payments systems and the Internet:

A joint meeting of the CSFI and the Financial Internet Working Group, with Charles Goldfinger (FIWG). June 12, 2002.

This was the second time in a month or so that we picked over work from the FIWG: this time, surveying work from its Institutional Payments Systems Working Party (set up in early 2001). The group's mandate is to look at the impact of the Internet on new and existing payment systems, to find out what consumers actually want, and to develop scenarios for change in the payment area.



Charles Goldfinger

For Goldfinger, new initiatives in Brussels matter. There is a Single European Payment Area initiative, involving 40 banks and three major banking associations (and no Commission involvement). There is work on cross-border payments – which has exasperated the Commission, given the lack of progress in driving down prices. In addition, the Commission is driving forward work in the M-payments area, with its InfoSoc Directorate (led by a Finn, the e-enthusiasts of Europe) getting as far as a legal draft on implementing a single framework for European payments.

The FIWG's role is to suggest that the Commission also look at the Internet. The first wave of Internet payment start-ups burned – and no survivors are left today. The second wave, from early 2001, had more players but as much failure. Only PayPal bucked the trend (and is its secret all to do with e-Bay, which is now buying it?). What of mobile payments? This is not a tale of mobile phones, ATMs and phone-to-phone credits. Rather, it is a story of how the wireless Internet can deliver payment solutions. But wireless remains slow (mobiles painfully so), and trying to enable payment systems that won't collapse under customer frustration is a problem and a half. Add in the lack of interoperability, and M-payments have a slow trajectory ahead.

Perhaps the greatest change could come from core payments systems – like SWIFT. Although submerged, the payments infrastructure does need modernisation – and (some) banks are hedging their bets with other solutions. But these are not necessarily competitive: banking systems, by their very nature, are restrictive and secretive.

Plus, what might the euro mean for e-payments? Consolidation and mergers are inevitable, and the FIWG recommends:

- structured cross-institutional dialogue, as banks have to be part of the solution; and
- greater sharing of central bank data (the ECB is important, and individual central banks have a lot of information).

There is, of course, much more (the full report is available on [www.fininter.net](http://www.fininter.net)), but the difficulties of coordinating a better system amidst many (entrenched) systems remain. Could the Commission knock some heads together? AE

## Op risk survey:

A round-table discussion of a recent survey by Logica into third-party op risk management. With Michael Zehetmayr (Logica) and Robert Bloom (Citigroup). June 13, 2002.

Who handles op risk best - and which systems deliver the most comprehensive risk management environment? These are the questions that Mike Zehetmayr tried to answer in a round-table looking at the present states of OpRisk systems in the market.

The driver for operational risk-analysis software - and the management systems that make them work - is Basel 2. Proposed changes to the Accord are pushing reform across financial institutions, even if opinion continues to be split as to whether to go for a big bang approach (investing in brand new, shiny risk management systems) or to puff along incrementally. There is a continuing problem with data - we have too little of it, covering a (relatively) brief timespan. Mapping extreme risk (the 1/10,000 event) is impossible with only a few years of data crunch.

This is why systems controls, and processes, matter as much as the IT. In the current space, businesses are looking at either quantitative or qualitative systems. Only two companies are amalgamating both. This is also why Logica decided to review what was presently available on the market, and assess packages against vendor reputation as well as functionality. This raised a few eyebrows around the table: ought vendor reputation (in such a fast-moving market) be one of the main evaluating factors? Zehetmayr argued that it should, given that banks will - if they go for a major system - be making a medium term commitment to a risk-management approach. Given this, banks ought to be confident that the vendor will still be around several years hence. Logica gauged this by assessing numbers of customers, time in the market, financials, etc. Out of the packages assessed, Algorithmics OpRisk suite came top overall, but Amelia OR2Q also scored highly. (Only RAFT was excluded - but should have been assessed too.)

PA Consulting has conducted a similar study, and the author (also present) pointed out that its conclusions were broadly in line with Logica's. However, rather than factoring in vendor reputation, PA broke the functionality axis in two, and looked at product lines against how effective they were at hitting both qualitative and quantitative targets.

Important questions were raised. What databases are there in the City, on a pan-industry basis, looking at OpRisk (including near misses)? PwC is said to have done work in this area, but have others? The task ahead is huge, and according to Zehetmayr, the IT spend and implementation cost to the financial sector could exceed that of Y2K. One other question: might non-financial services software providers enter the market? Presumably there are a number of risk-management applications applied to non-FS sectors that could, suitably modified, be sold within the FS marketplace. Logica believes that fresh players could come into the arena - although others felt that existing players are likely to remain dominant. AE

## **“Basel lite”:**

The first meeting of a CSFI working group on slimming down Basel 2, with Alistair Milne (City University). June 19, 2002.

OK, so sometimes the CSFI doesn't quite capture the City *zeitgeist*. We (and a lot of our friends) thought that Basel 2 was increasingly viewed as too complex, too unwieldy, and worthy of a fresh look - perhaps even from first principles. There certainly seemed to be scope for a working group to consider what a slimmed down version of Basel 2 - a 'Basel Lite' - might look like. But when we assembled a group of City folk under the lead of Alistair Milne, the verdict was far from unanimous. Yes, not everyone felt as starry-eyed about the new capital accord as the FSA and Treasury; nor were all the bankers convinced that the Basel Committee had done a terrific, 'listening' job. But the scale of discontent was a bit lower than we assumed, perhaps because the industry has swallowed the official line that it is a done deal.

Even so, there is a lot of interest in how Basel 2 will be implemented (we've looked at this before, but must return to the theme), and there is also no agreement as to how much of a rolling process Basel 2 will be. Elements of Basel 2 may be implemented early, and revised as successive elements are introduced. (See below for a brief summary of the group's second meeting.) AE

## **Basel 2 and the wider agenda: A transatlantic perspective:**

A CSFI round-table discussion with Erik Musch (PricewaterhouseCoopers) and Ray Soifer (Soifer Consulting). June 26, 2002.

How is Basel 2 viewed in the US - and how does that differ from perceptions in Europe? Ray Soifer, a well-known face on Wall Street, joined Erik Musch (once of the Basel Committee) to explain the differences and similarities in US and European approaches to Basel 2.

As Soifer began, given Basel 2 will only be applied in the US to internationally active banks (which could amount to only 6-8 since the spate of 1980s mergers, or perhaps as many as 100-150 if a broader definition is applied), most will escape the expense of implementing the new capital adequacy accord. Nearly all of the 8,000+ US banks operate mainly in the US, lending to the American *mittelstand*, SMEs and individuals. If Basel 2 were applied to these regional banks, their capital charge would rise significantly. For this reason, the latest quantitative impact study from the BIS is eagerly awaited. No US bank is fully ready to implement an advanced IRB approach. Although the Federal Reserve is supportive of Basel 2; John Hawke, Comptroller of the Currency and a member of the Basel Committee, has spoken frostily on some aspects of it, most notably the proposal to apply a specific capital charge for operational risk. Even

the AllFirst scandal does not advance this aspect of the Basel 2 agenda:

OpRisk capital requirements would only have covered about a third of AllFirst's losses, while better supervision (Pillar 2) might have prevented them. Perhaps the greatest difference in the US lies with the role of non-banks' in the banking space. Fidelity, AIG and GE are major providers of capital, and are not regulated as banks. US-European differences persist (for example, on accounting standards), and fair-value accounting continues to raise hackles. Basel 2 is about risk measurement; but shareholder value is about risk-management. Even so, nearly all US banks, like their European counterparts, are waiting on the Basel Committee before taking action to improve their risk management. A continuing atmosphere of uncertainty is proving counter-productive.

In Europe, Basel 2 is being taken to be about 'significant' (not just 'internationally active' banks), explained Musch. The EU intends to extend this by directive to all banks in the EU - which sets the EU apart from the US. And EU banks want the IRB approach rather than the standardised approach, which might impose higher capital requirements. There are other forces at play in Europe. Merger activity continues, helping to establish a much more competitive banking market. In Musch's view, Basel 2 will be implemented, fairly soon, but he does not expect a process that will lead to lower capital requirements. (This is perhaps a problem: after all, what incentives will banks have if there is no self-serving gain?). As a Citigroup banker explained, from their perspective they are presently overcapitalised in both regulatory and economic capital terms. We have to be hopeful (she added) that we don't end up with ridiculously large capital charges. A representative from the BIS defended Basel 2. We are trying to alter incentives, he explained. While the January 2001 paper led to people flinging up their arms, the protest has subsided. Basel 2 will go through - there is no turning back. From October to December 2002 the third quantitative impact study will crunch the numbers.

Soifer suggests that there are, nonetheless, dangers ahead. Major investment managers could be hit, as could developing countries. Emerging economies will still seek to protect their major 'national' banks from foreign competition, and will want to grant them the necessary clearances under a Basel 2 regime to allow it to compete effectively. Musch sees a rosier future in Europe, with competition pushing banks towards better risk management systems. AE

## **The future of financial advice in a post-polarisation marketplace:**

Second meeting of the CSFI working group (supported by Accenture), with Stuart Fowler. June 27, 2002.

Is the basic focus of the working group on cost-cutting? How far should we go beyond CP121 in terms of the proposals for provision and distribution of financial advice that are being floated? What weight should we give to preservation

of a face-to-face IFA industry (to what extent do we believe technology can replace personal advice for lower income groups)? These were some of the questions that informed our second meeting.

Perhaps inevitably, we focussed on what could be expected from the (then-unpublished) Sandler report. But those present accepted that demographics and inflation are key because of the need to achieve viable business models. For Fowler, it was a question of face-to-face advice – and whether it can be driven by technology or by skills and experience. How can sustainable business models be supported that reach down to C1s and C2s?

Sandler dominated the discussion: if ‘with profits’ commissions are limited, there could be a tremendous drop in profitability for the life insurance industry. This would have a knock-on impact on distribution, and could grievously wound the IFA industry. Despite 150-160 providers in this marketplace, those with the deepest pockets – rather than the brightest ideas – will probably survive.

Several useful suggestions included:

- the need for clearer product descriptions “on the wrapper”;
- the advantages of a two-tier regime, with lighter regulatory requirements for ‘safer’ products (the FSA is already trying to do this, by coding risk levels of different asset classes);
- the role of technology as a cost-limiter; and
- the interface between state benefits and financial products.

There is a continuing dilemma at the heart of financial advice. The IFAs, and government, feel advice is a ‘good thing’ and stimulates better behaviour. But for consumers, it may sometimes be the case that the best advice is to do nothing at all. And what ought to happen when advice is bad? Should a consumer ever be advised to go for products that provide a 4.2 percent return (possibly with risks, or associated charges) when a bank account can offer 4 percent?

What kind of business models might emerge and survive in the sector? Fowler believes that big institutions will survive, thanks to their reach and middle-class consumers. The Post Office could, potentially, represent the type of brand that could build on consumer trust to increase market share. Fowler anticipates a relatively small group of ‘best of breed’ giants. Supermarkets could make headway in this market.

One interesting angle was what kind of people do we need to sell financial services? More women are likely to be involved in future; in Germany, that’s (already) the business model. Technology will also make a difference. Five years ago the idea of selling a mortgage by phone would have been laughed at. Today, even IFAs use the phone to deal with clients – even if initial meetings are face-to-face. Technology, light touch regulation, and business models – these were the themes that informed the group pre-Sandler. AE

## Exchange-traded funds:

A round-table with Rainer Riess (Deutsche Borse), Manooj Mistry (Merrill Lynch), Lee Hodgkinson (virt-x), Rick Lacaille (State Street), Deborah Fuhr (Morgan Stanley International) and Chris Broad (LSE). July 2, 2002.

The days of the CSFI being wowed by product developments are past. As confirmed sceptics we’re rarely taken in by the spin of corporate PRs. But exchange-traded funds (ETFs) really are exciting – particularly in view of the backlash against active investment management in the UK post-Sandler. So what is so special about the ETF formula? Well, it does what it says on the tin. An ETF is a fund (like a mutual fund) but continuously tradable (just like an individual stock), with low management costs to boot. Add in the fact that they can be bought short or purchased on margin, and what you have is a truly agile product. In addition, in the UK they are not hit with stamp duty.

So is there a downside? Our speakers (three exchanges that trade ETFs, and two institutions that offer them) thought not. ETFs – if marketed sufficiently (and there were mild concerns about the lack of marketing budget for ‘low cost’ products) – ought to see similar growth in Europe to that they have already enjoyed in the US. At the end of the first quarter, the US listed 102 ETFs with around US \$89 billion in assets. In Europe, there were only 92, with 131 listings (cross-listing is growing). However, their total assets only added up to about US \$7 billion. Globally, ETFs manage just over US \$120 billion, with daily volume getting on for \$10 billion. These may be telephone numbers, but it’s still small change when set against global equity market capitalisation.

So what products now exist, and how does the market break down? There are pan-European ETFs covering banks, healthcare, technology and even, god forbid, telecoms. The LSE was late to the game, and has 5 per cent market share, while the Deutsche Borse has about 58 per cent of the European ETF market. Euronext (the only exchange missing at the round-table) has about 35 per cent of the market.

ETFs look like a cheaper and better mousetrap: but interesting financial journalists is going to be a hard slog. None came along to the round-table. Growth is, therefore, unlikely to be meteoric, but it ought to be workmanlike. Perhaps fixed-income ETFs (on their way) can break through the ceiling, as investors clamour for diversity. AH/AE

## Dealing with economic crime:

A round-table discussion with Richard Pratt, director-general of the Jersey Financial Services Commission. July 15, 2002.

There is now tremendous pressure on all financial institutions and financial jurisdictions to take a tougher line on terrorism, corruption and the proceeds of economic crime. The US is playing a leading part in this; so is the OECD’s Financial Action Task Force. The UK’s FSA has also been cracking down, with tighter “know your customer” rules. Not

surprisingly, some of the smaller financial centres around the world have been caught up in all this hustle and bustle – not always fairly.

A lot of attention has focussed on the UK's Crown Dependencies – notably, Jersey, Guernsey and the Isle of Man – which have long enjoyed an autonomous financial status that has permitted them to build up substantial and sophisticated financial sectors aimed primarily at offshore investors. The Dependencies have been extremely successful in attracting funds, the overwhelming majority of which are completely legitimate. Like many other centres, however, they have from time to time had problems with what are quaintly called “politically-exposed persons” – and, in the post-September 11 environment, any such problems are likely to be magnified.

How does a jurisdiction like Jersey handle this dilemma? The economy needs a healthy financial sector, and it certainly cannot afford to jeopardise the skill-set that has been built up over decades. But it also cannot afford to fall foul of the FSA or the US – and it clearly doesn't want to appear on FATF's blacklist. There is also a resource problem: for jurisdictions as small as the Crown Dependencies, it is simply unrealistic to expect that the domestic financial regulator will have the manpower needed to do the same kind of intense due diligence on all potentially suspect accounts that, in a perfect world, the FSA would like. So, is there another way? Richard Pratt (who was with LIFFE and HM Treasury before joining the Commission) thinks there is – and that it could get the smaller financial centres off the hook. He is currently floating the idea of an international clearing house, to which regulators (and banks) operating in smaller jurisdictions can pass on information about possibly suspect accounts. He also envisages an international body (the BIS or the IMF) acting as guardian of suspect funds that could be placed in an escrow account while the proper judicial process is launched to ascertain true ownership.

So far, his proposal has not been picked up, but it is clear that – if the smaller jurisdictions are going to stay squeaky-clean – they are going to have to get some help. Pratt's idea is one that is well worth giving some thought to. AE/AH

## The future of financial advice in a post-polarisation marketplace:

Third meeting of the CSFI working-group (supported by Accenture), with Stuart Fowler. July 16, 2002.

This (final) working group meeting covered a lot of ground – working hard on the draft paper that Stuart Fowler had produced. This was the first opportunity post-Sandler and Pickering to review what they had said, and to set that against work done by Fowler and the group. Fowler felt that CP121 and Sandler were weak in several distinct areas. First, consistency between industry practice and institutional markets (most products being sold are not consistent with a professional high-level understanding of the way in which markets and products work). Second, the impact of technology adoption. Fowler believes that the FSA underplays this. (Other members pointed out that consumer resistance, and consumer attitudes, matter – even if getting a handle on what those attitudes are is not always easy.)

One big difference between the group was on the subject of competition. Some felt that a single market model dominates financial advice – a silo model that cascades down. Products are manufactured, but the manufacturers also control distribution. The result is essentially a broking model in which brokers charge a commission for selling a product. Others disagreed: the system had changed, and it will change further as a result of Sandler and CP121. The critical issue is what will come in its place (at present, there is no clear vision of what market-based model would replace it).

There were other questions. Are financial products much like other major purchases (like a car)? Can they (as we suggested) be put ‘off-prescription’? Or are they more like health services – a different order of consumer good? Do consumers split into blocks that need general or specific forms of advice? Many present agreed that there is a serious problem with an outdated regulatory structure. The nature of IFA regulation seriously impedes a lighter, better service – delivering the lower-cost solutions that providers (and the public) can live with.

Finally, why have the banks been driven out of this space? They may not stay out for long, given various initiatives currently underway. Will an army of Mums with laptops manage to change the shape of the advice market more than Sandler threatens to? AE

## “Basel Lite”:

Second working group meeting with Alistair Milne (City University). July 24, 2002.

For this meeting, Alistair Milne had produced a four page outline of what he would hope to cover in any paper he might write for the group. Following the discussion (which largely endorsed this outline), it was agreed that the paper should focus on implementation issues – and that, where possible, it should offer indicative solutions to the problems raised (rather than just the usual whingeing). Among the problems raised that are worth looking at are:



Alistair Milne

- the strains on bank systems (*can* Basel 2 be implemented simultaneously, or will it have to be spread out?);
- the absence of adequate data sets, particularly for op risk;
- the impact of the “Enron factor” on demands for more transparency under Pillar 3 (just how “auditable” will the new data that is to be published have to be?);
- what Basel 2 will do to the appetite for bank stocks, *vis-à-vis* other sectors where similar disclosure requirements won't apply;
- how Basel 2 impacts on “public goods” like security of deposits, efficiency of banks as providers of credit, international competitiveness, etc.; and
- the potential interaction between Basel 2 and implementation of IAS.

Milne will now produce a brief synopsis for a practically-oriented paper, with a notional publication date in late autumn. AH

## From the director (cont)...

(continued from page 1) to make equitable (bad word) provision for old age in a society where people live much longer, where fewer and fewer companies offer plausible final salary pension schemes, where the super-returns that we have enjoyed on equities no longer prevail and where (in some eyes at least) there is going to be a shortage of bonds? (Linked to this is the problem of distributable reserves: if a company's first responsibility is to top up pension funds, we may be looking at a prolonged period of low dividend pay-outs – another lesson not to expect an early recovery in equities.)

Add to that the financial architecture question (we are particularly interested in what has happened to CDC), the current confusion in the clearing and settlement space and the likely realignment of exchanges in Europe, and we should have a busy few months. AH

Please note the latest change of staff: as of June, Alexandra Urry took over from Leela Wilson as the Centre's administrator.

**City competitiveness...** One initiative we are very interested in pursuing is to create a template for a regular survey that would assess practitioner perceptions about the competitiveness of the UK financial services sector, both over time and compared with other financial centres (NY, Frankfurt, Paris). This would require a questionnaire-based survey, to be followed up with in-depth interviews. We have articulated a proposal, and hope that we can make progress in the autumn.

## Publications

Another CSFI report has just come out. *Waiting for Ariadne: A suggestion for reforming financial services regulation*, by Kevin James, takes a critical view of the UK savings industry, and (perhaps more interestingly) proposes a fresh wrinkle, so-called 'Ariadne' funds, to provide a lower-cost product to consumers. It has stirred up a bit of controversy - prompting, in particular, a strong attack in the *Financial Times* from the director-general of the Fund Management Association. But it is a serious and timely piece of work which puts some numbers on the industry practices identified by Sandler. Copies are available through the Centre at £25 (or equivalent) a piece.

In addition, we hope soon to publish:

- David Lascelles's report on City trade associations (this incorporates a lot of material that has been collected by our interns over the last year, and will also include contributions from other observers of the lobbying scene);
- a major book on European e-finance (this was put on ice for a few months after the dot.com bubble burst, but is now almost ready to go to the printer thanks to special support from Deloitte Consulting and Newsdesk Communications);
- a paper on restructuring the audit profession post-Andersen (written by a former partner at one of the Big 4);
- a paper on breaking the monopolistic mind-set in the clearing and settlement area;
- a polemic against the perversions of the Commission's Financial Services Action Plan; and
- a report (by Allen Sykes and Bob Monks) on developments in corporate governance that we hope will be published in two versions - one (in British) for a UK audience and one (in American) as the first publication of the NY CSFI. AH

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