



SYMPOSIUM ON BUILDING THE FINANCIAL SYSTEM
OF THE 21ST CENTURY

AN AGENDA FOR EUROPE & THE UNITED STATES
LOUVECIENNES, FRANCE • MARCH 29-31, 2007

THURSDAY, MARCH 29

- 18:15 Reception – Outside Auditorium
- 18:30 **GREETINGS** – Auditorium
Hal S. Scott, Program on International Financial Systems (PIFS),
Harvard Law School
Karel Lannoo, Chief Executive Officer, Centre for European Policy Studies
- 18:35 **KEYNOTE ADDRESS** – Auditorium
Jörgen Holmquist, Director-General for the Internal Market and Services,
European Commission
- 19:30 Cocktail Reception – Outside Auditorium
- 20:00 Dinner – Château de Voisins
- 21:30-23:00 After-Dinner Cocktails – Cavoise

FRIDAY, MARCH 30

- 7:00-7:45 Breakfast – Restaurant
- 7:45-8:05 **OPENING REMARKS** – Auditorium
Hal S. Scott, Program on International Financial Systems (PIFS),
Harvard Law School
David J. Wright, Director Financial Services Policy and Financial Markets,
Internal Market Directorate General, European Commission
Mark Sobel, Deputy Assistant Secretary for International Monetary and Financial
Policy, U.S. Department of Treasury
- 8:05-8:25 **PANEL SESSION** – Auditorium
**Topic 1: Issuance of Securities: Corporate Governance and Liability
Regimes in the EU and the U.S.**
Europe Panelist: Christopher J. Bates, Partner, Clifford Chance LLP
U.S. Panelist: Randal K. Quarles, EF Ventures

8:25-9:55	<u>SMALL GROUP SESSIONS</u>		
	<i>Room</i>	<i>Facilitator</i>	<i>Reporter</i>
	1	Guido Ferrarini, Mike Wilson	Brandon Becker
	2	Peter Clifford, Charles Ilako	Jane Welch
	3	Simon Gleeson, David Devlin	Joanna Gray
	4	Dagmar Linder, Philippe Billot	Andrew Kuritzkes
	5	Nicolas Collier, Barbara Matthews	Eric Morgan de Rivery

9:55-10:05 Refreshment Break

10:05-10:25 **PANEL SESSION** – Auditorium

Topic 2: Trading of Securities: Market Regulation and Structure

Europe Panelist: Vivien Lévy-Garboua, Global Head of Compliance – Member of the Board, BNP Paribas Securities Services

U.S. Panelist: Brandon Becker, Partner, WilmerHale

10:25-11:55 **SMALL GROUP SESSIONS**

	<i>Room</i>	<i>Facilitator</i>	<i>Reporter</i>
	1	Karel Lannoo, Bertrand Huet-Delaherse	Brandon Becker
	2	Arnaud de Bresson, Emily Altman	Jane Welch
	3	Friedhelm Kläs, Sophie Gautié	Joanna Gray
	4	Peter Tils, Elizabeth Jacobs	Andrew Kuritzkes
	5	Peter Kurer, Lisa Rabbe	Eric Morgan de Rivery

11:55-13:00 Lunch – Château de Voisins

KEYNOTE ADDRESS

C. Boyden Gray, Ambassador of the United States, European Union

13:00-14:30 **PANEL SESSION – PLENARY DISCUSSION ONLY** – Auditorium

Topic 3: Derivative Markets, Alternative Products and Financial Stability Monitoring

Europe Panelist: Joseph Seidel, Managing Director & Counsel, Credit Suisse Securities

Europe Panelist: Andreas Gottschling, Managing Director, Deutsche Bank AG, London

U.S. Panelist: Keith Clark, International General Counsel, Morgan Stanley International

U.S. Panelist: Greg Zerzan, Counsel and Head of Global Public Policy, International Swaps and Derivatives Association, Inc. (ISDA)

14:30-17:45 Excursion to Versailles

14:30- 18:00 Reporters Meeting

14:30- 18:30 Free Time

18:30 **KEYNOTE ADDRESS** – Auditorium

Michel Pébereau, Chairman of the Board of Directors, BNP Paribas
Sir Win Bischoff, Chairman, Citigroup Europe

20:00-20:30 Cocktail Reception – Petit Salon

20:30-22:00 Dinner – Château de Voisins

22:00-23:00 After-Dinner Cocktails – Cavoise

SATURDAY, MARCH 31

7:15-8:15 Breakfast – Restaurant

8:15-9:30 **PRESENTATION & DISCUSSION** – Auditorium

Topic 1: Issuance of Securities: Corporate Governance and Liability Regimes in the EU and the U.S.

Europe Chair: Sebastian A. Fairhurst, Manager EU Affairs, European
Financial Services Round Table (EFR)

U.S. Chair: Jeffrey R. Shafer, Vice Chairman, Global Banking, Head of
Economic and Political Strategies, Citigroup

9:40-10:40 **PRESENTATION & DISCUSSION** – Auditorium

Topic 2: Trading of Securities: Market Regulation and Structure

Europe Chair: Piia-Noora Kauppi, Member of the European Parliament,
European Parliament

U.S. Chair: Alastair Sutton, Partner, White & Case

10:40-10:50 Refreshment Break

10:50-11:50 **PRESENTATION & DISCUSSION** – Auditorium

Topic 3: Derivative Markets, Alternative Products and Financial Stability Monitoring

Europe Chair: Martin Wieland, Director, International Financial System,
Deutsche Bundesbank

U.S. Chair: Stefan Gavell, Executive Vice President and
Head of Industry & Regulatory Affairs, State Street
Corporation

11:50-13:00 Closing Lunch – Restaurant

SYMPOSIUM REPORT

BUILDING THE FINANCIAL SYSTEMS OF THE
21ST CENTURY:
AN AGENDA FOR EUROPE & THE UNITED
STATES

MARCH 29-31, 2007
LOUVECIENNES, FRANCE

BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY: AN AGENDA FOR EUROPE AND THE UNITED STATES LOUVECIENNES, FRANCE, MARCH 29-31, 2007

The fifth annual Europe/U.S. Symposium was held at the BNP Paribas training centre at Louveciennes, France. Discussion focussed on three topics: corporate governance and liability systems in the EU and the U.S.; market regulation and structure in the light of MiFID and Regulation NMS; and derivative markets, alternative products and financial stability monitoring. The symposium was held against the backdrop of the continuing EU/U.S. Regulatory Dialogue and recent initiatives in the U.S. and EU to move towards greater convergence of their respective capital markets.

The Transatlantic Dialogue

The discussion of the specific symposium topics raised a number of general issues about the U.S./EU dialogue and the convergence process.

What is Driving the Dialogue?

Questions were asked about the ultimate objectives of the transatlantic dialogue. The U.S. is driven by erosion of its dominant market position because of increasing competition from other financial centres. But some participants questioned whether it was realistic to assume that the decline in its competitive position could be reversed. Many thought that the IPO market would never recover completely because there were now viable alternative markets for raising capital. Other financial centres have caught up in terms of transparency, liquidity and investor confidence. It was agreed however, that the U.S. could do much to halt the decline by adopting a more proportionate approach to investor protection and by removing some of the regulatory burdens and costs which currently deter many foreign companies from entering the U.S. market.

Convergence or Mutual Recognition

In seeking to bring the EU and U.S. closer together, there was some debate about which should come first—convergence or mutual recognition. EU participants stressed the need for minimum harmonisation before politicians or regulators would contemplate mutual recognition. EU experience demonstrated that total harmonisation was neither realistic nor necessary but, at the same time, there needed to be agreement on the basic standards which should apply, to engender the necessary mutual confidence. Participants were generally positive about prospects of the U.S. and EU moving closer together and on reaching a consensus on standards in certain areas.

Prioritisation

It was argued that there was an urgent need to identify and prioritise the topics which the EU/U.S. dialogue should address. Participants agreed that it would be easier to tackle the wholesale markets first. Regret was expressed about the lack of progress to date in integrating the retail financial markets in the EU, given the urgent need to increase choice and reduce costs. But it was accepted that the transatlantic dialogue could not address retail issues until the EU could speak with one voice.

Participants discussed whether attention be concentrated on those areas where the U.S. and EU are already close, e.g. corporate governance standards or on those where the shoe pinches most, such as Section 404 of Sarbanes-Oxley (“SOX 404”).

On a practical note, participants recognised the difficulty of comparing standards in the U.S. and EU for convergence purposes. EU standards may be articulated in EU legislation, in an EU Directive, but implementation of that directive by Member States can result in 27 sets of standards, set in the context of 27 different legal systems and enforced in very different ways by regulators with widely differing powers and resources.

Articulation of Standards—Principles or Rules

There was some debate as to whether convergence would be facilitated by a move towards more principle-based regulation. The arguments for and against rule-based regulation were rehearsed. But it became clear that very different considerations applied to the application of principle-based regulation in the U.S. and EU. In the U.S. principle-based regulation was seen as an essential part of the move towards more proportionate risk-based regulation, whereas in the EU concern was expressed that principle-based regulation would be interpreted by Member States in very different ways. It would increase the opportunities for differing implementation and gold-plating by Member States, thereby making the task of policing implementation and enforcement of EU law more difficult.

Convergence of Legislative Processes

Participants agreed that mutual recognition needed to go further than the standards applied in each jurisdiction. Each side needed to have confidence in the other’s rule-making process, enforcement powers and enforcement culture.

There was general support for the proposal that U.S. regulation should be subject to cost-benefit analysis. It was hoped that rigorous cost-benefit-analysis would lead to a more proportionate approach to rule-making, distinguishing between the needs of wholesale and retail customers for protection. The establishment of a wholesale/retail regime in MiFID was a good precedent.

Concern was expressed that transparency and legal certainty were liable to be compromised by the SEC’s use of enforcement action for ad hoc rule-making and through the “no fault” settlement system (see below). One factor affecting investor confidence in regulation in any jurisdiction is the speed with which that legislation can be changed, both in order to keep up with market developments and to correct anomalies.

Mutual Recognition of Enforcement

There was much debate about the importance of enforcement powers and procedures (explored in greater detail below). Many participants pointed out that mutual recognition of standards by itself was not enough; both sides needed to be confident that those standards would be enforced effectively. Participants were concerned that insufficient attention had been paid to monitoring and enforcing the implementation of EU law by Member States. Others pointed to the work now being done by CESR and the Commission in the context of the Lamfalussy reforms.

The point was made that the way in which standards were enforced could have a dramatic impact on the way in which those standards were perceived by the industry. The language of SOX was taken from banking regulation, but it was applied and enforced in a very different way by securities supervisors. Whereas bank regulators place more emphasis on low profile preventative prudential supervision, the SEC tends to concentrate on enforcement with maximum publicity. The consensus was that both the U.S. and the EU needed to change their approach to enforcement. Whereas the EU needed to do more to ensure compliance with its laws and to change the perception that EU enforcement was fragmented and ineffective, the U.S. was under pressure to curb the worst excesses of its enforcement culture.

Transatlantic or Global Dialogue

Some participants questioned whether it was sensible to attempt to maintain a dialogue with China, India and Japan at the same time as the U.S./EU dialogue, in view of the fact that their capital markets were at such different stages of development. The EU/U.S. dialogue already placed considerable demands on scarce resources and it was argued that it would be better to concentrate efforts on transatlantic convergence, where there was a prospect of earlier gains. The contrary view emphasised the importance of influencing developments in Asia through early dialogue. It was generally accepted that there was no realistic alternative to maintaining a dialogue with several countries at the same time, though the level of specificity would inevitably vary depending on the stage of development of the markets concerned.

Who are the Negotiating Parties?

As far as the transatlantic dialogue was concerned, there was some discussion of whether bilateral negotiations between the U.S. and individual Member States would be more fruitful than dealing with the EU as a whole. It was stressed by EU participants that the European Commission has exclusive external competence in the field of capital markets and that bilateral negotiations between the U.S. and individual Member States such as the UK were not possible. It seemed to some participants that the old complaints about regulatory fragmentation on the EU side could now be levelled with more justification at the U.S.

Should Dialogue Take Place at the Political or Technical Level?

It was argued forcefully by some participants that the dialogue was best handled by technical experts and that politicians should be involved as little as possible. But it was accepted that politicians needed to buy into the process, since implementation of any agreement reached would require legislative change on both sides, which would be impossible to secure without political support.

The proposal by the German Chancellor, Angela Merkel, to inject fresh life into the integration of the transatlantic economy through the establishment of a new transatlantic economic partnership was welcomed by many participants, as were the recent U.S. political initiatives to reconsider some aspects of U.S. securities regulation. It was stressed, however, that there was no sense of "triumphalism" on the European side that the U.S. was now prepared to reconsider aspects of its securities regime. Each side on occasion felt that it was the victim of extraterritoriality. The EU complained about the reach of SOX, while the U.S. had reservations about the spill-over effects of the EU Financial Conglomerates Directive and other EU directives.

Regulatory Competition

There was some concern expressed that the pressure to harmonise standards might lead to the demise of regulatory competition. This is still a vexed issue, both within the EU and between the EU and the U.S.. Whereas some participants thought that regulatory competition was undesirable and could encourage a “race to the bottom”, others believed it was healthy and indeed, inevitable as long as there continued to be wide disparities in tax laws.

Session 1

Issuance of Securities: Corporate Governance and Liability Regimes in the EU and U.S.

Shareholders in U.S. companies tend to have fewer rights in relation to control of executive compensation and election of board directors than their European counterparts. Participants were generally supportive of the move in the U.S. to introduce a requirement for an advisory vote by shareholders on executive compensation. But it was pointed out that more rigorous shareholder control of executive compensation in public companies could lead to successful managers moving to companies controlled by private equity.

The introduction in the U.S. of majority voting for board appointments would bring the U.S. into line with the UK and other EU Member States. But in other areas of shareholder voting, there remained significant differences. Whereas the U.S. has a system of one share, one vote, this is not the case in the EU.

In discussing the accountability of companies to their shareholders, the point was made by several participants that it was more and more difficult for companies to identify their shareholders. Ownership of shares was increasingly divorced from control of voting rights and concern was expressed about the ability of hedge funds to buy votes. Participants drew attention to the wide variations in national requirements to disclose major interests in shares in public companies and urged that this be treated as a priority for harmonisation.

Overall it was recognised that where shareholdings were widely dispersed, no jurisdiction had found the perfect accountability model.

Despite some differences on detail, participants felt that there were few significant points of principle separating the U.S. and EU on corporate governance. There were, however major differences between the two markets in enforcement of corporate governance standards.

U.S. Enforcement

The U.S. system of public and private enforcement, using a combination of criminal and civil, federal and state measures was criticised by many participants for its heavy-handed approach. While some participants thought that a rigorous enforcement system was a selling point for the U.S. market, others felt that the risk of litigation was proving to be a major deterrent for foreign companies considering entry to the U.S. market. On the other hand, some participants cautioned against exaggerating the deterrent effect of the litigious culture in the U.S.. Many foreign companies simply factored the cost of enforcement into the costs of doing business there and believed that it was still easier to make money in the U.S. than in many EU member States.

Private Enforcement

Participants accepted that class actions were deeply embedded in the U.S. political and legal system and could not be easily curbed. Securities class actions represented almost half of all federal class actions in recent years and the amounts recovered are a significant burden for public companies. But it was pointed out that injured shareholders rarely receive adequate compensation for loss through securities class actions, since all the costs fall on the company and are ultimately borne by the shareholders. The reality was that one set of shareholders was

simply suing another set of shareholders. There was general agreement among participants that the benefits of the securities class action, as it operated today in the U.S., do not justify the costs.

U.S. participants also criticised the practice of "pay-to-play," whereby plaintiff law firms make political campaign contributions in return for appointment to represent state pension funds in shareholder class actions. The same criticism was later made of political influence being exerted on the state enforcement process (see below).

Arbitration

Participants debated the merits of allowing shareholders to choose to adopt alternative dispute resolution procedures or non-jury trials as an alternative to class actions. It was recognised however, that this was not an easy choice for shareholders to make, but that, on balance, they should be given the right to weigh up the costs and benefits of different options.

EU Enforcement

On the EU side, it was pointed out that the possibilities of private enforcement were just beginning to be explored. Issuers were still trying to assess their potential civil liability in each member state where their securities were distributed under the EU Prospectus and Transparency Directives. In assessing legal risk, issuers also have to take into account the rules of private international law, as laid down for example in the Rome Convention on Contractual Obligations. There is no EU harmonisation of enforcement procedures, enforcement of EU legislation being left to the individual Member States. Some participants made the point that the debate in the EU centred more on the proper balance to be struck between criminal and civil means of enforcement.

Participants recognised that, in any event, there were procedural obstacles to class actions getting off the ground in Europe, such as the non-availability of discovery and fee shifting. Moreover, there was less incentive to bring class actions in Europe since recoveries were likely to be significantly lower than in the U.S..

Although the debate on class actions in the EU is only just beginning, it was pointed out that Parmalat has given rise to shareholder private enforcement action in Italy, in parallel with criminal proceedings. But other participants suggested that the apparent lack of enthusiasm for private enforcement in the EU might indicate a more fundamental difference in legal culture between the EU and U.S., observing that opportunities for private enforcement in the EU antitrust field have existed for years but no actions have been brought.

The majority thought that the EU should exercise extreme caution in embracing class actions, though the dissenting view was expressed that the importation of class actions should not be rejected out of hand before considering whether effective alternatives already existed.

Public Enforcement

Participants discussed whether the emphasis on tough enforcement of securities laws in the U.S. was gradually shifting to a more nuanced preventative prudential approach as a result of the regulatory changes allowing the integration of banking and securities houses. Some participants doubted whether the macho culture of federal and state enforcement agencies

would change quickly and argued that there was a need for greater coordination between the two.

It was pointed out that enforcement action against a U.S. firm is increasingly likely to have global ramifications. The U.S. prosecution of Arthur Andersen resulted in the demise of the global audit firm and the consequent reduction of audit networks with international capacity to just four firms. In view of the adverse consequences of such decisions world-wide, participants urged widespread consultation with regulators in other financial centres, before decisions of this nature were taken in the future.

More generally it was recognised that the liability system in the U.S. encourages an overly- cautious approach on the part of management, which some participants thought was an unwelcome diversion of effort from their main task of maximising shareholder value.

This is seen as one of the results of the requirement for audits under SOX 404, which requires public companies (including non-U.S. companies in some cases) to assess annually the adequacy and effectiveness of their internal controls over financial reporting and to have this assessment verified by their auditors. It was generally agreed by participants that, despite widespread support for the goals of SOX 404, the costs of compliance had proved far in excess of original estimates, while the practical benefits were difficult to quantify.

Public enforcement in the EU is something of a mystery to the U.S., because it is a matter for individual member states. It is now recognised as a major problem that must be tackled by the EU through the European Commission and CESR. The infringement procedures under Article 226 of the Treaty are too blunt and cumbersome to be effective. Overall there is a perception of over-zealous enforcement in the U.S., but under- enforcement in the EU.

Concern was expressed about the SEC practice of using enforcement action to rewrite the rules. It was undesirable that ad hoc rules should be made without the normal constraints on rule-making such as the need to consult. Similarly the SEC use of “no fault” settlement procedures gave rise to uncertainty about the standards to be applied. Other problems identified in relation to the enforcement process in the U.S. were the lack of coordination between Federal and state enforcers. Enforcement action by state attorneys-general can result in regulatory changes with national and even international consequences. Participants emphasised the political influence of trial lawyers in U.S. and stressed their strong resistance to any move to restrict their business.

Session 2

Trading of Securities: Market Regulation and Structure

Major changes to market regulation in the U.S. and the EU are due to come into force in 2007—Regulation NMS has already come into force in the U.S. and MiFID is scheduled to come into force later this year. Participants discussed the likely effects of these changes, particularly in relation to their impact on competition and competitiveness, within their respective jurisdictions and between them, though some participants felt that since neither regime had been implemented as yet, it was far too early to compare and contrast their impact.

It was recognised at the outset that participants were not comparing like with like. The scope of MiFID is far wider than Regulation NMS. Apart from reforming the regulation of investment exchanges and alternative trading venues, it extends the licensing and single passport system under the Investment Services Directive to other investment services and investments and harmonises conduct of business rules. Above all, it has to be seen in the context of the establishment of a single EU market in financial services. Regulation NMS on the other hand is designed to protect investors through the introduction of four main requirements: the Order Protection Rule, the Access Rule, the Sub-Penny rule and rules dealing with the distribution and display of market data.

Best Execution

Both measures are designed to secure best execution for investors, but each market has different preoccupations. It was pointed out that whereas Regulation NMS requires firms to trade at the best price publicly displayed, MiFID allows firms to take into account matters other than price, such as costs, speed and likelihood of execution and settlement. Further clarification of the scope of the exemptions under Reg NMS is required, together with guidance on the detail of firms' record-keeping requirements. Liability issues are still outstanding, such as the potential liability of a firm required to use a particular market which then suffers computer failure, but which disclaims liability. Who should bear the cost?

Data Consolidation

The two markets differ significantly in their approach to data consolidation. Regulation NMS institutes a single data consolidator and requires trading centres to report best prices to the data consolidator. MiFID has been unable to impose data consolidation on EU Member States and a solution is still awaited.

Data Fees

Participants highlighted other differences between the two regimes- whereas Regulation NMS limits the fees charged by any trading centre for accessing its quotations, MiFID does not regulate data fees. Reg NMS tackles the question of sub-penny pricing, which is seen as necessary to promote greater price transparency and consistency and to protect limit orders; MiFID is silent on the question.

Transparency

Participants asked about the likelihood of "dark pools" being created under the U.S. system when matching systems were not required to display orders publicly. It was concluded that MiFID would result in greater pre-trade transparency.

Impact on Exchange Consolidation

There was some discussion of whether the introduction of Reg NMS and MiFID would result in greater integration of the EU and U.S. markets, thereby enabling the merged NYSE /Euronext exchanges to operate under a single regime. It was recognised that the exchanges would operate under the existing national regulatory regimes for the foreseeable future and that the most that could be achieved in the short term was a common trading platform. Fears were expressed by EU participants about U.S. “regulatory creep” and the possible application of SOX to EU exchanges, but participants pointed to counter-measures such as the “Balls Act” adopted by the UK. There was a discussion of whether recognition of systematic internalisation and alternative trading venues under MiFID would lead to over-fragmentation and possible demise of the official exchanges. It was thought that talk of the end of exchanges was somewhat premature – they had survived similar threats in the past and on this occasion it was thought that they would simply respond to the challenge by lowering their prices.

Need to Keep Legislation Up to Date

In assessing the impact of MiFID and Regulation NMS, participants compared the speed with which the rules could be changed in the EU and U.S. It was remarked that it took 30 years to achieve Reg NMS, despite the U.S. advantages of a common language and a highly developed capital market, whereas MiFID would come into force just 12 years after the ISD came into force. Other participants were less sanguine about the speed of regulatory change in the EU, pointing out the length of time taken to make significant changes to other pieces of legislation such as UCITS and questioning whether all Member States would meet the implementation deadline.

Overall however, there was recognition that MiFID was a major achievement, given its ambitious scope. It was pointed out that it is also an important piece of the EU Single Market regulatory jigsaw, since it has to work with the CRD and Solvency II in relation to financial conglomerates.

Discussion of MiFID triggered a debate about the respective merits of directives and regulations as legislative tools. The use of directives was criticised because they allowed for divergent implementation by Member States. On the other hand, MiFID in particular was criticised for the level of detail contained in the Level 1 Directive, despite the Lamfalussy procedures now in place.

Session 3

Derivative Markets, Alternative Products and Financial Stability Monitoring

Are Derivatives a Force for Good?

Views were more starkly divided on the state of the derivatives market and whether they were an unmitigated success story than on any of the other Symposium topics. At the extremes, the view that all the back office problems have been sorted out and that the market is a success story was tempered by the contrasting view that there is no guarantee that the operational, risk management and customer suitability challenges have all been met. In particular, some scepticism was expressed about the proposition that derivatives spread risk. Some participants argued instead that the risks had merely been transferred to those least able to bear them.

The Operational Challenge

Although the industry has made major efforts to meet the operational challenge in the credit derivative markets, it is too early to say whether all the problems have been resolved. The backlog of unconfirmed transactions has not yet been completely eradicated, and continuing vigilance needs to be maintained to ensure that new operational problems do not emerge. There is also concern about emerging operational problems in the equity derivatives markets.

The Risk Management Challenge

On the risk management front, the industry faces major challenges in the valuation of derivatives and in the management of collateral as a means of mitigating counterparty risk. Customised illiquid products are increasingly common which makes proper valuation very difficult. Some participants questioned whether hedge funds were equipped to deal with the credit risks inherent in derivatives but were assured by others that institutions were very aggressive in analysis of credit and counterparty risk when their counterparty was a hedge fund. It was recognised that ISDA had made a major contribution to dealing with counterparty risk through the introduction of the "Dura Protocol" procedure, but doubts were raised whether the Dura Protocol auction procedure solved the problems where derivatives become divorced from the underlying assets, if those assets are in very short supply.

Customer Suitability

Participants expressed concern about the lack of information about where the ultimate risk lay. There was a fear that risk was being transferred to those least able to evaluate and bear it, such as pensioners through pension fund investment. This pointed to the need to monitor the distribution of derivatives to see where the risk ends up and to assess whether banks were selling products that were suitable for the customer. This in turn required firms to differentiate between sophisticated and retail customers, in terms of their understanding of risk. It was recognised that the risk of retail customers ending up with unsuitable credit derivative products was likely to increase if credit derivatives were traded on exchanges.

Arguments for Light Touch Regulation

The success of the derivatives market and its ability to ride crises seems to indicate that self-regulation works well and that there is no need for heavy-handed statutory regulation. On the other hand participants pointed out that the economic environment has been relatively benign, though it was accepted that the market had withstood shocks such as Enron, the rise in

oil prices and political coups in Thailand. This could be taken as evidence of the beneficial risk - spreading effect of the use of derivatives or alternatively of the fact that risks have been pushed far down the line. This reinforced the view that one of the major problems is the difficulty of getting timely, accurate and comprehensive information about the distribution chain.

Specific Problems of Credit Derivatives and Equity Derivatives

Equity derivatives raise different issues from credit derivatives, in particular the disclosure issue—who is the ultimate controller of the shares in a company. It was argued that there was a need for harmonisation of shareholder disclosure thresholds and for definitions of interests in shares to include equity derivatives. The cost of compliance with the differing national requirements was described as huge.

It was argued that transparency requirements should apply to equity swaps, currently used by hedge funds to conceal share ownership. These make it possible for hedge funds to hold voting rights without holding any economic interest in the shares. The example of the UK was cited where the Takeover Panel includes equity derivatives in its disclosure requirements.

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