

# 26th International SFOA Bürgenstock Meeting, September 7<sup>th</sup>-10<sup>th</sup>, 2005

Summarized report by Michael Brewer, Word+Image

## Wednesday, September 7, 2005

The 26th International SFOA Meeting at Bürgenstock literally got off to a roaring start when the Royal Air Force Aerobatic Team, the Red Arrows, delivered a stunning performance of aeronautic prowess against a majestic backdrop of snow-capped Alpine peaks. It was certainly an auspicious start to what promises to be an interesting conference, even by the SFOA's fabled high standards. This year's meeting is hosted by the City of London represented by an array of companies and organizations, which literally moved heaven and earth to present such a brilliant display.

SFOA Chairman *Paul Meier* welcomed this year's meeting participants in the refurbished conference room of the Palace Hotel, which conference veterans were quick to note now features air conditioning. Mr. Meier pointed out the appropriateness of the demonstration of precision flying offered by the Red Arrows for the SFOA Meeting. The qualities that make a successful jet pilot are similar to those that lead to success in the derivatives market: consistency, innovation and precise risk management. To accommodate the growing success and popularity of the Bürgenstock meeting, an extra day has been added to the event to allow more time for panel discussions and social interaction.

*Gerhard Odermatt*, Director of the Canton of Nidwalden, the Swiss canton in which Bürgenstock is located, stepped up to the podium to welcome the meeting participants. He was followed by Roy S. Leighton, Chairman of Nymex Europe, Ltd., representing the City of London, this year's conference host.

The keynote address was given by *Alan Yarrow*, Chairman of LIBA - London Investment Banking Association. In what was surely the opening shot of the conference, he presented his view of "**Financial Markets in Tomorrow's World**", or rather, the view of this particular association of market users. He believes the most significant future issues include ensuring sufficient capital, European financial market reform, the lowering of exchange fees and user governance in a consolidating world. While LIBA generally prefers to pursue quiet diplomacy, they seem to be adopting a more vocal stance regarding the issue of market consolidation and in particular, the lack of progress in the reduction of exchange fees.

The subsequent panel group was quick to take up the gauntlet and the diverging interests of market users, clearing houses and exchanges soon became clear. In answer to moderator *Roy Leighton's* provocative two-part question – Are exchanges too profitable and is demutualization the stepping stone to greater efficiency? – *Michael Spencer*, CEO of ICAP plc, clearly stated that he does not see a return to the old world of mutualism. He believes that demutualized exchanges are better equipped to move forward, though he does admit that the headiness of the early days of privatization has waned. *David Hardy*, Group Chief Executive of LCH.Clearnet Group Limited, offered his views from the aspect of clearing. He too sees remutualization as infeasible, however opined that a compromise must be found between the interests of customers and shareholders. He offered LCH.Clearnet's constitution, which stipulates the consideration customers' interests in all the company's activities, as a template for moving forward, a point which even Mr. Yarrow agreed with. However, not all were in agreement with the keynote speaker's views regarding lower exchange fees, particularly *George Gero*, Board Member of the New York Mercantile Exchange, who expressed the opinion that lowering fees will not be useful in the long run and could ultimately lead to uncompetitive exchanges. Moving on to the topic of clearing, *H.E. Alexis Lautenberg*, Swiss Ambassador to the UK, reflected on the rapid movement to a global marketplace over the past 20 years. He pointed out how the efficiency of the system is having an increasing impact on the global economy, and feels that governments missed the opportunity to achieve a sense of global regulation, which now seems to be increasingly hindered by the current bottom-up approach.

At the Eurex press dinner, held at the Bürgenstock Golf Club, CEO *Rudolf Ferscha* shared the challenges the company has experienced thus far in 2005. He provided an upbeat update of the

company's antitrust lawsuit against the Chicago Board of Trade and CME, a view likely not shared by said companies. Mr. Ferscha enumerated an impressive list of products in the pipeline, including the launching of a new 30-year future on government bonds. In response to Mr. Yarrow's earlier criticism of the reluctance of exchanges to lower fees, Mr. Ferscha insisted that "Eurex delivers the lowest derivatives exchange in the world, and the gap is widening." Whether this went down with the press corps as well as the fine meal they enjoyed remains to be seen.

All in all, the 26th International Meeting at Bürgenstock is off to a rousing start. Stay tuned.

## Thursday, September 8, 2005

The second day of the 26<sup>th</sup> International SFOA Meeting in Bürgenstock greeted the participants with golden sunshine and glorious views over the Vierwaldstättersee. Those who resisted the temptation to go sightseeing were rewarded with a day full of captivating panel discussions.

*Jean-Marc Felix*, Head of Communication and Member of the Executive Committee of the Board, Swiss Bankers Association, started the session with an introduction to the impressive world of Swiss banking. Banking is a tradition so embedded in Swiss culture that one cannot properly view it outside the context of the nation as a whole. With its phenomenal infrastructure, its climate of adaptability and legendary Swiss quality and efficiency it is little wonder that Switzerland is among the world's top banking locations.

The first panel discussion addressed the topic **Changing Media and Derivatives**.

The eloquent *Werner Vogt*, Media Spokesman for SWX Swiss Exchange launched the discussion by commenting on media prejudice, illustrated by a story running this morning in the local press regarding the Red Arrows flight display enjoyed by the SFOA meeting the previous day. Apparently, the local Swiss cows and chicken failed to appreciate the "entertainment for 300 bankers". With news of such caliber demanding media attention it is natural to wonder whether journalists have the time to properly report on derivatives. *Claudia Gabriel-Schneider*, Economic and Financial Editor of the venerable *Neue Zürcher Zeitung*, pointed to the jungle of information that must be weeded through to find any real information about derivatives. *Herbert Skeete* agreed that it can be challenging to stay fully informed when new instruments are being introduced on a daily basis. *Douglas Trainer*, a Partner at Luther Pendragon, spoke of the challenge of overcoming historical perceptions of the industry, which still impact the public mindset. The complex nature of derivatives leads to a default to comfortable concepts. *Madeline Boyd*, SVP of External Affairs at NYMEX, sees one of the biggest challenges in area of education, which her organization fosters through its website, workshops and seminars, by providing access to specialists and by keeping ahead of the onslaught of new products. *John Lothian*, Editor & Publisher of the renowned *John Lothian Newsletter*, admitted that the news cycle today is so fast that even knowledgeable journalists find it hard to keep up. As *Werner Vogt* stated so succinctly, "nobody wants to admit that they don't know", while Mr. Trainer advised the meeting, "keep your friends close and your journalists closer."

After the coffee break, the second panel addressed the question **"Has technology delivered?"** Panel moderator, *Clive Furness*, Managing Director of Contango Markets Ltd., gave each of panelists time to talk about whether technology has indeed delivered in his or her organization. *Bruce Goldberg*, Senior Vice President, Marketing at ISE, sees all technology as being in a state of evolution, and should be assumed guilty until proven innocent. *Kevin Ashby*, CEO of Patsystems, said that companies must innovate to move further up the value chain. He feels that today's patent-driven world hinders cooperation. *Tim Geannopoulos*, EVP Global Sales at Trading Technologies, a company for which the word patent is not exactly Swiss German, insisted that protection of innovation keeps his company from cannibalization. He pointed out that it is five times more expensive to innovate than it is to copy. *John Oddie*, Director of Software Engineering at Euronext.liffe, feels that the patenting organizations do not really understand what they are patenting. And *Christian Schild*, Head of Global Sales for RTS Realtime Systems AG, views patents as a catalyst to innovate, if only to stay one jump ahead of the patent process. Technology may have delivered, but it also bears new challenges in its wake.

Attendance was up markedly for the first afternoon panel discussion, **"China & its influence on Asian development"**. Well at home in the world of emerging markets, moderator *Patrick Catania*, Member of the SFOA Board, spoke optimistically of how the world financial markets are gearing up for increased

Asian activities, while markets in Asia continue to open, modernize and join the global marketplace. He introduced *Ji Xiang Yu*, Deputy General Director, Department of Future Supervision, China Securities Regulatory Commission. Through his masterful interpreter, Mr. Ji characterized the Chinese derivatives market as moving from an initial period of wild growth into a subsequent period of consolidation. China currently has over 180 brokerage firms, of which 22 are authorized to trade overseas. Following the heady volatility of the early years of derivatives trading in China, the state council issued provisional regulations which are driving the market's consolidation phase. Mr. Ji modestly admitted that compared to the developed world markets, China's futures markets are still in their infancy. However, China's track record in other markets leads one to conclude that this is a nation of fast learners. Now if we could just get him to smile...

Joining Mr. Ji from China was *Wang Lihua*, Chairwoman of the Shanghai Futures Exchange. Mrs. Wang said that China needs a futures market to encourage future growth, which has taken off in an even more impressive fashion since its WTO admission. While the Shanghai Futures Exchange remains tiny, trading in just four basic commodities, perhaps being smaller is better when reaching tentatively for basic transparency and greater efficiency. Yet, even at this early phase of development, it is not uncommon for Shanghai metal prices to impact prices in London markets, an indication of the market's maturation. Also on the panel was a representative of the world's largest futures market, *Falsafi Arman*, Managing Director, CME Europe & Asia, which has been a presence in Asia for over 20 years. CME is in various stages of development throughout Asia and sees itself as a partner that can help development of the Chinese futures market. *Nick Ronalds*, Director, ABN AMRO Futures Group, recalled witnessing first-hand the astounding growth of the Chinese futures market, from zero futures exchanges in 1989 to 55 in 1995. He highlighted the phenomenal strength of the Chinese copper market, which has boomed since 2003. While the LME remains the benchmark in Asia, the Chinese markets are making themselves felt. With the panel opened for questions, *Alan Griethuysen*, asked Ms. Wang the question on most everyone's minds: When we be allowed to trade on your exchange? Ms. Wang disarmingly stated that at our exchange we look forward to welcoming you, which when translated literally from Mandarin might well mean "not anytime soon". Mr. Ji added inscrutably, the time is not yet right".

Rounding off the discussion for the day was the question, "**Will the commodities boom go on?**" Panel moderator *Daniel Hodson*, Chairman of the University of Winchester, asked the panel consisting of both investors and exchange representatives to address this issue of interest to most conference attendees. Swiss investor *Thomas Della Casa*, Head of Alternative Investment Research, sees the market at point of fundamental change with increasing demand and abundant liquidity provided by hedge funds. *P. H. Ravikumar*, Managing Director and CEO of the National Commodity & Derivatives Exchange, is bullish about future prospects for derivatives in India, though the market is currently limited to smaller traders to avoiding overheating. *Joseph O'Neill*, SVP of the New York Board of Trade, agrees that the demand-driven market will ensure continued growth, fueled by developments in Asia. *Anthony Belchambers*, CEO of the Futures and Options Association, provided a more bearish view, pointing out the various issues that could potentially weigh on the boom, such as regulatory prejudice and the persistent perception of commodities as high-risk derivatives. Driving the bear to the edge of the chasm was *Heiko Thieme*, Chairman of American Heritage Management Corp., who envisions oil becoming the primary commodity of the 21<sup>st</sup> century, while gold declines to relative obscurity. In the short-term, he predicted that oil prices have reached the high water mark and sees no rationale for the current high prices. *Tara Kimberly*, CEO of Four Winds Capital Management, took a more bullish tact when she expressed her conviction that the boom will indeed continue, though she cautioned that there is a need for an increased focus on market users.

## Friday, September 9, 2005

The weather gods smiled once again on the third day of the 26th International SFOA Meeting in Bürgenstock, lifting the clouds and rain of the night before and ushering the day in with sunshine. Despite the evident toll exacted upon the participants by the meeting's traditionally fine nighttime social activities, attendance was good in the conference room of the Palace Hotel.

Discussed in Friday's first panel, the provocative topic of "**Exchange traded & OTC - Convergence or Contradiction?**" Moderated by *Richard Metcalfe*, of International Swaps and Derivatives Association Inc. in New York, the panel addressed the issue of how these two trading modes stand in relation to one another. *Garry Jones*, CEO of ICAP Electronic Broking, Europe, cautioned that the lines have blurred between the two. They share common interests, such as the largest financial

institutions, which are providers of liquidity in both. The adoption of electronic trading systems in OTC companies means that they are beginning to take on the appearance of exchanges. *John Foyle*, Deputy CEO at Euronext.liffe, sees the relationship between exchange trading and OTC as a symbiotic one, in which they act as parallel markets which are not necessarily converging, but which do share common characteristics, such as external clearing. *William Brodsky*, Chairman and CEO of the Chicago Board Options Exchange, sees this symbiotic relationship as one factor that is fueling tremendous growth. On a more cautionary note, however, he added that you cannot preordain how things will develop, you have to rely on the creativity of customers. Markets are not static situations. Representing the regulatory side, *Sharon Brown-Hruska*, Commissioner at the Commodity Futures Trading Commission in the US, was refreshingly candid in her remarks. She noted that the CFTC's sister commission, the SCC, has grappled with the issue of market fragmentation and found mixed evidence as to whether internalization is detrimental to customers or markets. Mr. Brodsky, added that market fragmentation is not necessarily a bad thing. If markets are price improving, then order flow will increase, or in other words, if you build it they will come.

After the coffee break, the second panel took on "**Hedge funds - a discussion of key industry issues**". Panel moderator, *Nicola Meaden-Grenham*, Founder and CEO of Dumas Capital, Ltd. underlined the veritable explosion of hedge funds in recent years with impressive facts and figures. The industry itself is growing increasingly institutionalized and democratic. *Bruce Ruehl*, President and CIO of Gleacher Fund Advisors, sees an interesting time in the hedge fund business in general, one in which a disparity of return and a variety of regulatory issues make static strategies unworkable. *Hans-Jörg Baumann*, Chairman and Senior Partner of Swiss Capital Group, believes that in all aspects, size matters, when it comes to markets, in business and in terms of product risk. Any time you enter a market with substantial funds, you immediately impact that market. Regarding the question of leverage, Mr. Baumann believes the level of leverage has decreased in the hedge fund business in recent years. The banks, which are heavily regulated, exercise the greatest leverage today. *James Proudlock*, Partner at MPC Investors Ltd., sees a need to separate the risk management side of the hedge fund business from the actual trading. He considers hedge funds to be self-regulating. Without returns, funds simply close. Mr. Baumann countered the common perception of hedge funds as a risky business and drew a parallel to the Red Arrow flight display viewed in Wednesday. Despite the occasional crash, commercial air travel is widely considered to be safe. No airline pilot would dream of attempting to take risks that are daily practice for Red Arrow pilots. They are specialists, qualified to take such risks because they are aware of the variables. To successfully navigate the skies of hedge funds also requires specialization and qualification. It is a complex world, not for the faint of heart.

After the lunch break, the third panel addressed the issue of "**New products**". Moderator *Brendan Bradley* listed several common conceptions about new products, including among others, the high costs of R&D, the opinion that shareholders should bear the cost of development and that products must be instantly fungible. The panel's sole representative on the broker side, *John Mathias*, Director at Merrill Lynch, sees a recent leveling off of product introduction in comparison to 5-6 years ago, where it seemed nearly out of control. He feels that exchanges have learned to listen to customers and even went so far as to suggest there might even be too few products in the pipeline today. *Simon Heale*, CEO of the London Metal Exchange, added that many "new" products are not really so new, but are further refinements of existing ones. The discussion then veered into a culinary analogy. Mr. Heale chided *Joe Raia*, Vice President at NYMEX, for what is perceived to be that company's "spaghetti" approach to new products with cleared OTC products, likening it to throwing a plate of pasta at the wall and seeing what sticks. He contrasted that approach with LME's more methodical, i.e. slower, "potato" method with exchange traded products, carefully probed with a fork to check that they are thoroughly baked before consumption. Mr. Raia, however, was having none of this, and insisted that NYMEX ran a full range kitchen offering both types of dishes. Saving the panel from further spiraling into questionable food analogies, *Peter Reitz*, Member of the Executive Board at Eurex, pointed out that both the end-user and the FCM's must be considered and involved in a new product launch to ensure success. You have to bring in the right mix of people. And to dip back into to the food analogy, while too many cooks may indeed spoil the broth, consulting only with the kitchen staff is not a very effective method of product development. He admits that there is no secret recipe for successful product development, but there are numerous proven ingredients, including extensive customer communications, education all down the line, timing of the launch, and naturally, a pinch of luck.

Following the coffee break, the conference was treated to an interesting keynote speech entitled "**Ecology and derivatives – the way forward**" by *Eric Bettelheim*, Chairman of Sustainable Forestry Management Limited. A Bürgenstock veteran, returning now after a considerable absence with a new

sense of purpose and direction. Inspired at Bürgenstock by *Richard Sandor*, he has gone on to partner with him in a creating a venture that trades in stored carbon credits. Mr. Bettelheim made an impressive presentation that graphically illustrated the pace and scale of our planet's natural resources, which have been historically considered to be unlimited, including air, water, energy, water and biodiversity. As the human population continues to grow (6 billion now, projected 9-12 billion in 2150), competition for limited resources will increase. This makes a strong business case based on simple supply demand, one that markets cannot ignore. While the new emerging markets may seem exotic, they do embody a real and current value.

The subsequent panel discussion, moderated by *Steve Zwick*, Editor of Futures Magazine, offered a tangible glimpse of the future which is already at our doorstep. Adoption of the Kyoto Treaty by the EU has fueled the growth of CO2 credit trading exchanges and other schemes to enter this interesting emerging market segment. *Peter Koster*, CEO of the European Climate Exchange, and another Sandor-inspired entrepreneur, views global changes from a business perspective and envisions his current activities as a European petroleum exchange growing into a full range of eco-products. *Hans-Bernd Menzel*, CEO of the European Energy Exchange, called this new field the beginning of a revolution, one that he hopes will contribute to a better world. *Giorgio Szegö*, Chairman of IPEX, the Italian Power Exchange provided a rather startling view of the renuclearization of planet Earth as perhaps the only viable way to provide a sustainable source of power. According to Mr. Szegö, while industry is the popular whipping boy for climate problems today, the greatest share of CO2 to the atmosphere is emitted by rice fields. He advocates a new focus on the problem of electricity storage and the issuing of corresponding certificates. The various views and approaches of the panel members directly involved in the so-call eco-markets underline the fact that it is still early days in this new field. Mr. Bettelheim said that it is uncertain whether there is enough liquidity and volume to ensure the success of many of these new eco-derivatives, but it would seem that some movement, even if fragmented is better than none at all. The rate of development will depend on political pressure according to Mr. Bettelheim, who also feels that George Bush was right in rejecting Kyoto, but is wrong in not seriously addressing this issue. We are amidst a very interesting experiment to see if the private sector can address this major issue that confronts the entire world.

### **Saturday, September 10, 2005**

The Palace Hotel conference was full for Saturday's greatly anticipated **Crossfire**, skillfully moderated as always by *Patrick Young*, CEO of erivatives.com and Chairman of Derivatives Vision, who soon had the audience laughing with his rapid fire and highly entertaining soliloquy. In a wide-ranging and interesting discussion of the some of the most burning issues facing the derivatives markets today, he asked a series of probing questions that challenged the high-powered panel to provide thought-provoking insights. The panelists included:

*John Damgard*, President of Futures Industry Association  
*Heiko Thieme*, Chairman of American Heritage Management Corp.  
*Antoinette Hunziker-Ebnetter*, Member of the Executive Board, Julius Baer Holding Ltd.  
*Paul L. Doody*, Global Head of Sales and Trading Products, Reuters S.A.

When Mr. Young asked the panelists why the US is not more willing to allow other markets in, he turned to *John Damgard*, who countered that foreigners can easily buy US products and that it can be equally tough for US customers to participate in foreign markets. *Antoinette Hunziker-Ebnetter* described the US market as "protectionist", but also sees movement towards an opening. *Heiko Thieme* scoffed at the notion that Americans are open to internationalization, pointing out that 70% of Americans don't even possess a passport, a claim that can also be made by 50% of the members of congress, leading him to call the US "somewhat of an emerging market".

*John Damgard* commented that Eurex seems ready to beat a hasty retreat back to Europe. He feels that the slow pace of global market integration among the derivate exchanges is due in part to regulatory issues. The US market is the largest, most open market in the world that has until recently enjoyed a virtual monopoly. The US regulatory authorities have been slow to acknowledge the quality of foreign regulation, and while the regulatory scheme is relaxing, it will probably be too late to save Eurex's attempted foray into the US from going bust. However, he acknowledges that competition is essential to the business. *Heiko Thieme* suggested that we all regulate ourselves. He sees a trend towards a sort of criminalization of risk-takers, as if taking risk makes one suspicious. He fears it could

mean the end of entrepreneurship in the US. *Antoinette Hunziker-Ebnetter* pointed out that this is not just a problem in the US, in Switzerland too there is far too much paperwork and bureaucracy, which is ineffective and costly. She feels that value can still be found in the US, which remains the world's liquidity center. Mr. Thieme cried out, "Go East young man!" where he sees the greatest opportunity through less regulation and more risk. *Paul Doody*, from an information provider's point of view, welcomes regulation, which he believes creates an opportunity. *Patrick Young* suggested that a regulator clamp-down might bring the speculator boom to a halt, as the speculators move to freer markets. However, Mr. Thieme pointed out that you always have boom and bust when volatility increases and that common sense dictates some regulation. He sees speculators as serving a purpose at the margins, but as a danger when they begin driving the market.

Then followed a discussion of markets. *Patrick Young* wondered why Reuters does not move into the clearing business. *Paul Doody* replied that Reuters prefers to retain a neutral stance, but is moving towards becoming more of a hub. *Heiko Thieme* agreed that Reuters / Bloomberg better serve the industry by remaining neutral. Mr. Young noted that Reuters has basically decimated the open outcry system, yet in a development that seems to counter this trend, Nymex is opening a new open outcry exchange in London next week.

Other topics included a riveting exchange about contemporary men's business fashions and rationalization, leaving one to wonder if there might not be some mysterious link between the two. Mr. Doody's vested interests clearly lie in less rationalization, the more exchanges the better for Reuters. While *Antoinette Hunziker-Ebnetter* admitted that she has no crystal ball, she pointed out that the first to consolidate will have a clear advantage. *John Damgard* sees fewer mergers happening in the US due to the preponderance of lawyers, the justice department and the FTC. However, he noted, the CME is sitting on a pile of money and is definitely in the mood to acquire.

On the topic of how much shareholder politics influence the drive towards consolidation, *Heiko Thieme* noted how shareholders need only hold a stock for one minute to have a vote. He likened this situation to nation states, in which visitors to countries do not automatically receive voting rights. Citizens themselves must be at least 18 years of age to vote, giving them time to mature and become responsible. He argued that a similar system should be introduced in companies as well. Protecting national interests led into a discussion of the prospects of a non-European purchase of the LSE. *John Damgard* noted that the LME is a British national treasure and that political concerns were sure to play a considerable role in its ultimate fate. *Heiko Thieme* agreed, pointing out the immeasurable psychological value the LME embodies. *Paul Doody* disagreed and compared it with the recent demise of national airlines and how Switzerland seems to have gotten over the loss of its flag carrier. *Antoinette Hunziker-Ebnetter* believes Europe's financial center will remain in London. Noting that the City's demise has been predicted many times before, *Patrick Young* believes that its advanced level of internationalization and generous tax laws will continue to keep it a major global player.

The 26<sup>th</sup> SFOA Bürgenstock Meeting came to an official close with words of thanks and appreciation from SFOA president Paul Meier. While some hit the links for a round of golf, others prepared for the evening's gala dinner, while still others caught funiculars, boats, trains, buses and planes for the long journey home, down from the lofty and noble heights of Bürgenstock.

**Michael Brewer, Word+Image**, SFOA Conference Journalist for Swiss Derivatives Review  
Word+Image provides top-quality text, translation and graphic design for leading industry, the financial and IT sectors. Visit our website at: [www.wordandimage.ch](http://www.wordandimage.ch)  
Ibisingutstrasse 4, 5621 Zufikon, Switzerland / Tel. +41 56 631 54 57 / Fax +41 56 631 54 56  
E-mail: [wordandimage@swissonline.ch](mailto:wordandimage@swissonline.ch)