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CAN THE CITY ADAPT?

Lecture 6

HAS MUTUALITY COST THE CITY DEAR?

by

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Picture a group of senior financial executives sitting round a table in March 1979, discussing the creation of a new institution to look after the professional interests of an underrated and underrepresented class of managers, the corporate treasurers. The Pioneers, as they have become affectionately known to insiders, were about to put their hands in their pockets (for a fiver only, admittedly) and their reputations on the line for the founding of the Association of Corporate Treasurers. I had the honour to be amongst them at that fascinating moment, although I don't believe that any of us had an inkling of the size, influence and effectiveness of the infant to which we were proposing to give birth. The extent of our risk was further undermined by my still vivid memories of being rung by the then banking correspondent of the Financial Times and being given a royal journalistic blast for my effrontery in supporting such a notion. I became used to getting my instructions from journalists later on in my career but at that time it was a first. Yet the Association has never looked back. 350 initial members – more than we ever dreamed possible – has now swollen to 2,500. It is expertly delivering its mission to its members and the business community, and it is hard to see how such a body could have been other than co-operative.

It is interesting to reflect that many similar groups of dedicated people have for centuries met in these rather mundane circumstances with a vision, and a mission to realise it, taken the equivalent of a deep breath and thrown themselves into the difficult and unsung task ahead. They have all been pioneers of a type and on their efforts has been built the massive co-operative or mutual movement which has spawned many of the great institutions of our country, particularly in financial services: building societies, mutual insurance companies and exchanges for example. They have had a key role in building the economy and financial markets of Britain, and we have demonstrated a national genius at their creation, but is their mutual status as useful, necessary or effective as it has clearly been in the past? It is my purpose tonight to explore this question with particular relevance to the City, and to its formal markets in particular.

My contention in this lecture is that the reason for the creation of co-operatives is to provide a service to their members (or beneficiaries) not available elsewhere; that for cooperation to work properly there must be a common purpose and vision shared by the membership; and that good governance is a key to success but difficult to achieve in practice. Co-operatives are of less relevance and may founder when their products or services are available from other sources, usually from commercial competitors with a for-profit motive. They also cease to be effective in making critical decisions when their membership is divided on issues which are fundamental to their continued health.

That said, they have been of great benefit to the City in the past, and in some forms, such as the London Clearing House (LCH), they will continue to be. Even where they have had to be demutualised to survive in a competitive world, as in the case of LIFFE or the London Stock Exchange, their co-operative era was of huge and lasting impact, and their fate in their new incarnations is not of major significance to the City's global position.

I must be a glutton for punishment, for my career seems to been almost continuously involved with co-operatives. I will draw heavily on my experiences at the Nationwide Building Society of which I was Deputy Chief Executive from 1989 to 1992; the London International Financial Futures and Options Exchange or LIFFE of which I was Chief Executive from 1993 to 1998; and the London Clearing House with whose mutation into a co-operative I was deeply involved as a result of my LIFFE role, and on whose board I sat. However as an aside, in addition to my role in the development of the

Association of Corporate Treasurers, I am also Chairman of the Design and Artists Copyright Society, an institution designed to collect copyright fees on behalf of not just painters, sculptors and designers, but also photographers.

Let me deal first with a common misconception: the difference between a mutual and a co-operative organisation. In my mind – I shall probably run into difficulties with purists here – there is no tangible practical difference between the two, although a mutual may be so defined in its corporate structure, the most common style being 'mutual society'. Furthermore there is a strong tendency for people to use the words interchangeably regardless of their statutory or corporate structure, and certainly I see the aims, objectives, activities and stakeholders of each being virtually synonymous.

In general a co-operative could be described as a corporate organisation whose principal purpose is to serve the interests and common purpose of a specific group of beneficiaries, who may or may not be shareholders, by the provision of a defined range of products and/or services.

And why were they created? In order to predict the future of these organisations it is also necessary to understand their origins and development. Thus many have beginnings based on the social deprivations of those with lower incomes or little political or economic clout, and were driven by the social consciousness of the era in which they were founded. They were, if you like, founded to protect and assist the weak, using the strength which came from numbers of people banded together, as opposed to the puny position of a single individual. In this category come the Building Societies, a 19th century phenomenon, which provided a safe haven for the savings of the less well off, and then used those accumulated savings to provide the opportunity for the same savers in due course to borrow to finance their houses. Their products were deposits and mortgages and their objectives were simple and limited – to provide essential financial services to those who could not otherwise obtain them easily or at an appropriate price.

There is no doubt that the Building Society movement served the less wealthy and underprivileged classes of this country well. It gave them access to housing finance and a safe haven for their savings which was probably not available elsewhere. Although it grew and outstripped these original purposes, it continued to have a relatively unique and central role, becoming until relatively recently the source of most mortgage and other housing finance. Building Societies had an essential purpose throughout most of the movement's life, and their governance structure protected their objectives and gave their membership a direct say in their activities.

But the markets have now changed. Housing finance is available from many sources, and many more are safe havens for retail deposits, however modest. Why should societies stay mutual if their original purposes have been fulfilled, and their members could receive substantial windfalls if those societies changed their status? The economic argument has to do with trading off better terms, as allegedly available in a building society, for a dividend, as available to the shareholders in a PLC financial institution. For this equation to work the financial benefit of the better terms must be of greater value to the members than the windfall which they might receive. It is hard to see how this might be so. For a start, recent market initiatives have indicated that internet based banks with consequently low overheads can compete on more than equal terms with building societies for deposits, and even more conventional commercial institutions have been able to meet building society terms on many occasions. Thus even the 'better terms' argument is stretched, and particularly over the next few years until building societies have moved more into the online world and can take advantage again of their not having to pay dividends. More, however, the likely size of the windfall is probably far greater than the aggregate value of the benefit over many years. And it is interesting to note that it is technology which may be largely contributing to this effect.

I have also heard it argued that societies have a different culture and attitude to their customers and their welfare. This was true for many years, and indeed was one of the reasons why other retail institutions have become so much more user friendly. But their service is not noticeably better than other high street financial service retailers, perhaps because several former building societies are now banks and have brought that attitude and service with them into the commercial sector. Now building societies are competing fiercely in the same markets as many other institutions, and when you probe beneath the superficial trappings, there is very little to pick from the consumers point of view between them and their competitors.

Furthermore, the governance structure has, certainly for larger societies, not been of variable protection or usefulness to members. On the one hand the building society movement provides its members with the right to elect its board directly, to vote at Annual General Meetings (AGMs) and at Extraordinary General Meetings and to also to vote directly on certain defined and fundamental issues, such as demutalisation. In this respect the rights are not unlike those of the shareholders of a classic Companies Act entity. This is an interesting point in itself, for it is possible to make a crude argument that the building society members are close in economic and franchise terms to shareholders of a limited company, but without the rights to dividends and the agonies and ecstasies of the rises and falls in the value of their shareholdings.

But there is however one key difference in effect. The influence of limited company shareholders will vary according to the size of their shareholding, from a single owner at one extreme through an influential but not huge institutional shareholding in a plc to a tiny individual shareholder with a handful of shares. Their power over the board and the strategic direction of the organisation will be proportionate to their percentage share. Not so in building societies where the shareholding is completely atomised; in the case of some of the larger ones in several million pieces.

Another frequently aired argument is that building society AGMs are democracy in action, and that the right to elect directors has demonstrably resulted in the airing and resolution of issues, and indeed the expulsion of board supported directors in favour of the choice of the multitude of members. There is more than a grain of truth in both these propositions, from my direct experience. Few of us who sat on the podium will forget the six and a half hour meeting of Nationwide's AGM in 1992, at which wave after wave of verbal assault was launched against board and membership by the society's assembled members. Not only was it impossible not to admire the strength of the Chairman's bladder, but it must be said that they had a point. For years the building society movement had exploited depositors' inertia by launching new types of investment product with keener rates than those paid to members who kept their savings in older products – and without drawing the opportunity to convert to the attention of the individual saver. With hindsight it was inequitable, and we deserved the flak, in common with other societies.

However we had by that time already repaired our fences and set proper procedures in motion, publicly goaded less by our shareholders than the personal finance columns, although it is true to say that the level of private complaints had risen to record highs. In truth it is probable that the shareholders were often better able to get redress by going to the press than by complaining directly (and the Building Societies Ombudsman was far from robust in supporting the members' position). More typical of AGMs were those adroitly handled by an earlier chairman, who would listen politely to a member's often very reasonable outburst and then say 'Thank you very much, Madam' and call for the next question. He saw no reason for a response and the questioner was left stranded and speechless, all passion spent. It was a marvellous technique and one which I can highly recommend to the Chairmen of public companies with the panache to carry it off – but only to questioners who deserve such treatment, of course.

It might also be possible to argue that more has been achieved in democratic terms by direct election of directors. The Nationwide board has suffered at least two defeats in the form of the rejection of their chosen candidates in favour of outside people. Such upsets can give very curious results. In one of these cases the sitting director was a man of the very highest diligence, competence, experience and repute, and was replaced by a former manager, who had suffered recent redundancy, and had far less to contribute to the benefit of members apart from a detailed knowledge of the Society. And in recent years of course the pressure for demutualisation has resulted in single issue outside candidates standing, and the subsequent vote has been taken as a proxy mandate for adopting or rejecting the notion. In the case of Nationwide, I cannot but wonder whether the almost infinitesimal margin by which the vote was won by the pro mutualisation camp was in reality such a mandate or the opposite – a huge moral defeat amounting to a rejection. Good or bad governance? An interesting question.

And so it is hard in my mind to sustain an argument for the continued mutuality of most societies, although it is true that they continue to have a common objective. The members can obtain much the same product pricing in the commercial market, and if they were to receive their windfall, the annual dividends from investing in the shares of a comparably sized financial institution, would considerably exceed any better terms available from their society as a result of its mutuality. Their ability directly to influence events is minimal.

There are however some strong arguments for the continuing existence of the movement. The first, and weakest, is to provide choice and diversity in the market place, but at what cost one wonders? The second is that many societies do still provide a service to those disadvantaged people who genuinely would not find housing finance, places to deposit their, often very small, savings and who would allow them to have a cheque book. Many regional societies do go out of their way to bank the unbanked and bring them within the orbit and opportunities of modern financial service markets. And there are still some societies which have strong affinity, or club like features, and who may have a special interest in caring for the financial requirements of minority groups, most noticeable of which is the Catholic Building Society with its obvious affiliation. The movement will clearly continue to benefit such people, but the continued rationale for remaining mutual for the rest of the movement looks increasingly dubious.

Turning now to City institutions, the original Stock Exchange, and Lloyds had similar origins – they arose from the informal arenas, mainly coffee houses and then the Royal Exchange, where deals were struck, which subsequently coalesced into the formal markets which exist today. It is hard to see how they could have taken on anything but a co-operative framework, given the attitudes and environment of the day, and the fact that they were physical markets requiring a floor (or a Room in the case of Lloyds) creating a clubby feeling and sense of unified purpose. Indeed they had a such a common purpose, to create a liquid and safe market where they could trade for themselves and for their clients, setting their own rules within the law, and subsequently the external regulatory framework, and with a view to their own profitability. The governance structure was democratic and they had, through the board and the highly empowered committees not only a strategic but also a day to day hand in the running of the organisation. For many years they were very successful because, in general terms, the unity of purpose continued to exist, the arrangement was in the interest of all, and, in any event, there tended to be a near monopoly in the products traded.

Let me now turn to LIFFE as an important case study into the rise and fall of co-operative structure and governance in a financial institution. LIFFE happened to be in the City, but the lessons are universal. Anyone who went to the floor of LIFFE in its heyday, and particularly when the market was busy, could not have been but struck by the esprit de corps, and the pride in the sense of belonging to such an exclusive club. This was exemplified by the way in which those who worked on the floor wore their wonderful blazers throughout the City as a badge of belonging to such a rare institution. Indeed many overseas participants were sucked into this magnet of support, which had all the characteristics and the passion normally associated with football fans of their chosen club. They became LIFFE devotees through and through, even despite in some cases working for banks who originated in cities which regarded LIFFE as a bitter competitor to their own local exchange. I truly believe that one reason that it took so long for the DTB to make the final breakthrough in the battle for the bund contract that I have described in earlier lectures was that extraordinary loyalty which the floor and its co-operative nature nurtured and which made so many of those who worked there quite impervious to what was becoming an inevitability.

But a number of things upset the applecart, leading inexorably to the failure of co-operative governance in LIFFE's hour of crisis, and its replacement by a commercial for profit framework. First, although it was exceedingly rare for an exchange to start up as a commercial for profit enterprise with a physical floor, many have done so recently, without the so-called benefits of cooperation or mutuality, and with a high degree of success. In Europe the two supreme examples are the DTB, now Eurex, and the Swedish OM exchange. They were and are both unashamedly commercial in intent. This not only begged the question as to whether the existing, co-operative exchanges should remain mutual or indeed whether some of the more recently created ones, such as LIFFE should have been mutual to begin with. Alternatively, perhaps they should, where they are or have converted to for profit status, have done so long ago.

It was these newcomers who started to highlight the inherent difficulties in co-operative exchanges, for they brought competitive challenges which required quick and decisive action, at almost every level, particularly in pricing and marketing terms, and also of course in respect of the relative advantages of an electronic trading platform. They also challenged the basic co-operative tenet that the service would not be available from another source. But it was a subtler challenge: what definitely was not available from another source was a physical trading floor.

At the same time, the common purpose element of mutuality was beginning to break down. In LIFFE's case there were already beginning to be minor splits, principally because, as the exchange grew and its participants become wealthier and more powerful, they were forming into informal groups, often overlapping, but with different interests to protect and nurture particularly when it came to big issues. The noisiest of these, and therefore wielding disproportionate power, since noisy people seem in this life to get their way more often than quiet ones, were the floor traders. There were others too. For instance the international brokers for whom London was only one exchange in which their clients needed to be serviced, as against the locally grown brokers whose business was exclusively in London; or the minority product groups, particularly those representing option traders and brokers, and the commodity and equity market participants. During this period before the great competitive threat became so life (or LIFFE) threatening, I used to say that if there five identifiable constituencies in the exchange it was possible to get things done against the wishes of one, but only with the greatest difficulty if that one were the floor; it was virtually impossible to get them done against the wishes of more than one, regardless of the balance of advantage to the exchange and its participants as a whole. The fact was that the governance system gave a disproportionate share of power to minorities.

There were also inherent weaknesses in governance. At board level, although directors were typically very competent and professional in their specialist knowledge of the market, its requirements and its mechanics, they were often inexperienced in the workings and dynamics of plc type boards. They were generally young, and/or specialists and comparatively few had previously served on boards elsewhere. Some found the discipline of a supervisory board very difficult to cope with, and tended to look at every decision in terms of how it affected them, their employer and, as importantly, those who had voted them into the board – their 'constituency' if you like – rather than the interests of the exchange as a whole. To counteract this we used every year to explain to directors what their duties were, both of confidentiality, and, under the Companies Act, to the institution and its shareholders, rather than to any sectional interest. But the board was incredibly leaky, by tradition and habit, based I believe on the notions of market transparency and also on the lingering desire to let the so-called constituents know what was going on.

The critical vote at Hanbury Manor in July 1997 to which I referred in earlier lectures was a case in point. The marginal vote in favour of predominant investment in electronic trading was critical but highly controversial. It may perhaps have been particularly galling that in the bar the previous evening those who opposed electronic trading were certain that they would win the day. As a result the voting numbers and who voted which way were the topic of open conversation on the floor and throughout the exchange the next day despite all urgings for secrecy. What was also interesting about that vote was the contrariness of the voting, clearly illustrating the difficulties of board democracy in an exchange like LIFFE. People whose employers would, if offered the chance to form a corporate view, have supported electronic trading voted against it, by conviction and, if the trading floor was their professional origin, not a little emotion. This was a perfectly proper thing to do and in accordance with their duties as Companies Act directors. However there were undoubtedly others who knew that the best interests of the exchange in the long term probably lay in electronic trading, but who voted against it in order to support what they saw to be their short term profitability.

Another unwelcome aspect of governance was the seeming inability of the board to keep its discussions to strategic decisions, and an endless tendency to get bogged down in minutiae. The prices in the traders canteen exercised the board at great length and many times during my tenure. This made board meetings unconscionably long, often from 9.30 till after 1pm, when many if not most had left for a wellearned lunch. This was however never before one particular director had packed his papers and left pointedly after exactly two hours, no doubt making a sensible point. They also had the habit of reopening issues – usually the most trivial – constantly, particularly if the reopening party had already left for a gin and tonic when the issue had been discussed at the previous board.

A final issue was the outlandish size of the institution, which during my time was between 22 and 25. It was a parliamentary occasion to which the 80:20 rule applied, in other words 80% of the talking was done by 20% of the attendees. The comparatively silent 80% did not necessarily have nothing to say. They were either cowed by the occasion or ground down by their prolix colleagues.

Had the status quo been maintained this would have been and was difficult enough to manage, but faced with decisions which affected the entire livelihood and profitability of various constituencies within the exchange, but differently in each case, the governance system simply failed to deliver until it was probably too late. The key issues were of course brought about by competition: the trading platform used, electronic or open outcry, and the pricing of the products. It was clear to many observers that electronic trading posed a potentially fatal threat to the floor as soon as the DTB moved its market share of the key bund contract to 30% within a relatively short time after it opened for trading. As I have said before, I accept my fair share of the blame for what went wrong, nor do I specifically point the finger at any other individuals, rather the overall system and framework within which we were bound to work. Indeed I have often wondered whether, if I had been CEO in a for-profit commercial environment, I might perhaps have had the perspicacity to persuade a small, commercially oriented board that it was in our best interests to acquire a potentially globally distributable electronic trading system as a contingency several years before the fateful vote at Hanbury Manor endorsed – just – the concept of putting the bulk of our resources behind electronic trading. If I had not done so, the failure would have been entirely mine, and my neck, and possibly that of my chairman's, would have been rightfully on the line. We would have got the strategy wrong and would have deserved a sticky end.

In this context, it's amusing to recall that at least one member of the board, when it was clear that we should with hindsight have adopted this approach, complained that we should have undertaken the development of the new system 'secretly'....

During this period I found it hard not to envy the commercial decision making process of our competitors who, knowing the shortcomings of co-operative governance, were able to outwit and outmanoeuvre us at every point. Contrast the two systems: the board of the DTB would make strategic decisions, based on their longterm benefit to their shareholders, and stay well out of pricing and other operating decisions which it left to management. The board was able to act in the best interests of the institution without prejudice to any sectional interest, and the management were empowered to do the rest, without fear of interference in operating matters. Of course they were also liable to the penalties of managers who fail. We however were bound by a board which struggled to make decisions at almost every level, and often reversed them; and by a committee system below the board which further disempowered executive management.

Could these shortcomings and difficulties been foreseen by the founding fathers and visionaries of LIFFE? What we now know is that the co-operative governance adopted could not, when faced with a crucial and fundamental decision, and in the context of a deeply divided membership, make it early or decisively enough. It might also have been clear that electronic trading would not fade away, but would continue to attract adherents, so that sooner or later the exchange would be potentially faced with a choice between two very different platforms, or at least the expense of providing a choice. Furthermore the commercial for-profit model, as was of course unanimously accepted by the membership in June 1998, might have proced considerably more resilient both at a strategic and operating level if in place from the beginning.

Nonetheless, it is easy to see that, until comparatively recently, it would have taken an act of supreme courage and foresight to have decided, in formalising or setting up an exchange, to have made it a commercial for-profit organisation rather than a mutual one. Not only was mutuality the accepted wisdom, but such exchanges were for the most part successful and 'if it ain't broke, don't fix it'. The floor based community, resembling a closed club in so many ways, and commanding the same type of loyalty, was seemingly designed for such a status.

It was therefore hardly surprising that the founding fathers of LIFFE were drawn to the mutual structure. Other London exchanges had adopted it, it clearly worked here and went with the strong co-operative tradition not only in the City and financial institutions, but in professional bodies and throughout the British national life. The crucial decision was the choice of trading platform, and here again the choice was reasonably clear. The models for financial futures exchanges were the two great Chicago exchanges, the Chicago Mercantile Exchange (CME) and the Chicago Board of Trade (CBOT), many of the founder members were steeped in the Chicago traditions, and there was a feeling of cultural affinity based on an anglo-saxon view of financial markets. Electronic exchanges were in their infancy and nobody could be sure that they could ever replicate the liquidity, depth and price-discovery mechanisms which were the hallmarks of floor based derivative exchanges.

In any event it is probable that the necessary financing and institutional support for such a new exchange would probably not have been forthcoming in the context of anything other than a co-operative effort, at any rate at that stage in the evolution of financial markets. Thus a co-operative format was the only way forward. It is hard therefore to see how the events that ultimately unfolded could have been forestalled. Indeed it is possible to argue that only an open outcry exchange could have built the necessary early liquidity which helped to develop the exchange traded futures and options industry, not only in the US but successfully translated across to both London and the continent of Europe to LIFFE's early rival the MATIF in Paris. It was perhaps a necessary evolutionary process, soon to be overtaken, but inevitable.

And so despite the agonies of change, the co-operative histories of LIFFE and the Stock Exchange, as it moves towards its own change of status, did in their time do the City proud rather than ill. Indeed the period of their greatest success – from Big Bang in 1986 to the late 1990s – was the time in which London established and maintained its huge lead over its continental rivals and its premier global position. Mutuality was a key ingredient in the City's success, and helped immeasurably to bring it triumphantly through a key phase in its development.

But, as I have argued, their continued success is of less value now to a City whose global worth can be better measured by the numbers of key decision makers who work there. And at their level the real challenge lies ahead in their ability to cast aside all the old residual habits of cooperation – large comparatively inexperienced boards and powerful committees for instance and behave from top to toe like commercial companies with third party shareholders. It may prove difficult – old habits die hard – but it will be vitally necessary to their continued survival.

For there is at least one sinister development which may ensure that if they do not do it themselves, it may be done for them. Only a few days ago, the Deutsche Borse announced its intended Initial Public Offering or IPO, with a view to raising in excess of £500m of free cash for expansion. Think how many exchanges, including perhaps the LSE and LIFFE, this sort of money could buy! The vision of a pan European exchange may soon be realised, but not perhaps with the degree of consent implicit in earlier models.

As I have argued in earlier lectures I do not believe that the ownership of formal exchanges matters too much in determining the success or otherwise of the City. But there is a lingering chauvinism which makes me hope that such great institutions, having come so far, can quickly shake off their co-operative past and traditions and stand in the ring on equal terms with a mighty continental rival.

So can mutuality ever work in a financial institution facing competition in the fierce markets of today? There is one at least whose success bears examination, and that is the London Clearing House, which competes with other similar for profit institutions but is itself a co-operative owned by all those firms, big and small, who clear at its constituent exchanges.

The first test of successful mutuality is that the resultant product or service should in principle not be available elsewhere. I have, in an earlier lecture, documented the metamorphosis of LCH from ownership by the six leading clearing banks to the London clearing community, and I will not stray into too much detail. I was deeply involved in that turbulent process, and the main problem was how to provide the fund which stood behind LCH's backing of exchange derived commitments, in the case of loss. It is interesting to record that it was the very realisation a) that the clearing banks were indeed intent on relinquishing this responsibility and b) that the only alternative was ownership by the exchanges cleared there which propelled the clearing members of the latter into a mutual structure to clear in London. Clearing was vital to them – for many it was by far the most profitable part of their exchange activities – and they wanted to control LCH, but the quid pro quo was acceptance of the responsibility for the clearing default fund. At that time the end result, control of the London clearing could not have been achieved any other way.

The second test is a commonality of purpose, with no major issues now or in the future likely to divide the membership. Here again, perhaps assisted by the relative simplicity of the clearing concept, the members clearly face in the same direction and all look principally to an efficient, cheap well managed clearing service. There are of course ripples. Institutions with triple A ratings make money out of the quality of their credit, and do not always like the idea of clearing houses in effect reducing credit risk on exchanges to the same level – to the rating of the clearing house itself, usually perceived as triple A itself. They have for instance been for that reason very much in two minds about the acceptability of LCH' ventures into clearing off-exchange, OTC, products, like (I will not explain in detail) swaps, which to some extent compete with their other activities.

It might be argued that this position may be unstable. Increasingly, appropriate lines of insurance are providing the comfort in the event of default that the LCH default fund, put up by its (co-operative) members, currently does. But no doubt the members would be glad in due course to drop this irksome burden in favour of insurance, but to continue in mutual ownership.

Will competition and/or the need to make difficult decisions in the face of complex and divisive issues damage LCH and its co-operative structure and governance? There is a strong chance that they will not, and for two reasons. First it has the good fortune – in reality foresight on the part of those who designed its mutual governance – to have a relatively small board. In addition the experience and level in career terms of its members too was generally higher than at LIFFE in its co-operative days. Clearing seems to have been given a higher priority within member firms than the governance of the exchange which generated the business, a curious anomaly, but one, allied with a clear community of interest and vision, which makes LCH' board a particularly constructive one.

Secondly, LCH is able to engender and make use of a strong sense of community or clubbiness. The fascinating fact is that this not only supports the clearing house itself in its endeavours, but is very important to London as a financial centre. Institutions like the idea of a co-operative clearing community in London, and I believe, as I have argued in an earlier lecture, that LCH will continue, for that reason, to be one of the factors which draws and maintains those critical decision makers to London.

However, as I speak, a strategic joint venture followed by a possible merger between LCH and Clearnet, the clearing house for the Paris Bourse. I do not comment on the business drivers behind this project, but if the merger comes to pass, it will be fascinating to see whether the shareholding assumes a co-operative or independent, for profit shape. Could that be a rock on which the deal might ultimately founder?

Be that as it may, mutuality lives and still supports the City, as it has historically, the financial underclass, professional bodies and many other aspects of our national life. But it is not unchallenged, and it should be constantly subjected to the simple tests I put forward at the beginning of this lecture. Does it provide a service not available elsewhere, is there a commonality of purpose amongst its members and beneficiaries, and is its governance effective? If not, its commercial competitors have shown that it is likely that they can provide a comparable service more cheaply, more efficiently, and are better able to cope with the demands of inevitable change. In that case the onus will be well and truly on the relevant institutions to show why they should not demutualise, and the sooner the better.

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