THOUGHT LEADERSHIP DTCC

Trust: The Currency of Business

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Introduction

Our industry is still struggling as a result of a challenging, complex and increasingly costly regulatory environment as well as economic headwinds that are hampering the ability of many firms to grow.

However, I believe there may be an even more troubling issue facing the industry – the deep cynicism and skepticism the public feels toward financial services. This lack of trust in our industry has the potential to be more damaging than any regulation or economic trend.

Given this backdrop, there are three topics I'd like to discuss. The first is the trust deficit our industry currently faces and how we can go about restoring trust in financial markets and institutions. Second, the unique role financial market infrastructures can play in this effort, and third, how enhancing transparency and increasing resiliency will strengthen the financial system and, therefore, help restore public confidence in financial services.

The Trust Deficit

Let me begin with the trust deficit. Many of us in financial services tend to talk about the 2008 crisis in analytical terms or its impact on the industry – the collapse of Lehman Brothers, the near meltdown of the financial system, and the re-regulation of global markets and the heightened requirements we now face as a result of new mandates. In doing so, we oftentimes forget the human toll of the crisis – the dramatic decline in housing prices that forced many hard-working homeowners into foreclosure, the local shopkeepers and merchants who had to close their stores due to a lack of business, and our friends and neighbors who have had to put off retirement because they can't afford not to work.

It's no wonder that over the past seven years the perception of financial services has changed for the worse. We've gone from being seen as a respected industry that valued its clients and acted in their best interests to an industry singularly focused on increasing shareholder value at the expense of its clients.

This perception continues to define the industry despite important steps that we have taken since 2008 to regain public confidence. Over the past 7 years, banks have become stronger and their balance sheets have gotten smaller. Trading practices have improved and capital positions have been strengthened. Still, trust in financial services is at an all-time low.

Our industry now ranks dead last as the least trusted sector in the global economy, according to the 2014 Edelman Trust Barometer. This is particularly troubling because the currency that underpins financial services is trust – trust that when you invest in a mutual fund you will get your money back…trust that when you apply for a mortgage your broker is honest and not setting you up for financial ruin…trust that the money you put away in a 401k plan or pension fund will be there for you during your golden years.

For all our efforts to strengthen the financial system and implement controls to protect the end investor, only 50% of respondents in the Edelman survey expressed trust in financial services – well below industries like healthcare, Big Pharma, Big Tobacco, chemical companies and even the media.

This trust deficit is a problem for financial services in all regions of the world but is most pronounced in the European Union, where only 29% of respondents expressed trust in financial services.

Unfortunately, there are some very good reasons why this is the case. For example, we've had the Libor scandal, FX rate fixing, money laundering, tax evasion, misleading product descriptions. To quote a comment I heard at a meeting at Davos and which is powerful in its simplicity, "It probably would help if we stopped having scandals." Obviously, but saddening that it had to be stated. Furthermore, the public no longer fully understands what we do because financial products have become so complex and, in some cases, appear to only serve the best interest of Wall Street.

Rise of the Sharing Economy

While there have been many important changes in our business, the financial crisis sparked a dramatic transformation beyond the financial industry – most significantly with the rise of the sharing economy in which people are monetizing assets and leveraging technology to sell goods and services directly to their peers.

This represents dramatic change – both in society's attitude and behavior and in the desire among consumers for a more personalized transaction. It also reflects a shift in trust from corporations to individuals. Can you imagine 10 years ago someone feeling more comfortable using Airbnb to rent a room, or even just a mattress on a floor, in your house for a night over staying at the local hotel? The thought that my daughter would gladly seek out a stranger for a car ride home at midnight in New York City would have appalled me a few years back; now it is a norm.

While services like Airbnb and Uber have the potential to revolutionize entire industries, Kickstarter and other similar platforms, which effectively allow entrepreneurs to bypass the capital markets to raise capital directly from friends, family and strangers, could one day do the same to finance. Since 2009, Kickstarter has funded 77,000 projects with pledges of $1 billion from 7.7 million investors, and 44% of projects have achieved their funding goals. While Kickstarter is not intended for investors to profit financially, does anyone doubt that a new platform will soon emerge that is designed to do just that?

Rebuilding trust with the public is a business imperative in my view because, just like regulations or changes in market structure, the advent of new technologies and the expansion of the sharing economy will impact the role of financial services in society and, ultimately therefore, the long-term viability and relevance of financial firms.

How to Restore Trust

Restoring trust in our industry will take time, but the Edelman Barometer did offer insights and recommendations into how we can go about this task. The survey identified 16 attributes, organized into 5 categories, which can serve as a roadmap for our industry to improve our reputation with the public and, over time, strengthen our bottom lines.

At the heart of this effort is the need for us to enhance engagement and demonstrate integrity. In simple terms, this means that we need to listen to our clients and employees, we need to act in a manner that is honest and authentic, we need to be transparent and ethical in our actions and we need to take responsibility to address an issue or crisis.

The other three categories from the survey are equally insightful, including the need to deliver high-quality products and services and drive innovation; the need to have a larger and more meaningful purpose beyond our business goals and objectives, such as corporate social responsibility initiatives, and the need to develop outstanding operations, including having the ability to deliver consistent financial returns to investors and have highly regarded and admired leadership. Innovation must be seen as serving the interests of our clients and not simply as a means of increasing margins through complexity. We, as an industry, must also understand that we do serve a public good, be it through providing access to worthy investments or through risk management, both on a retail and institutional level. And lastly, a proper profit motive overseen by management and governance which understands what "doing the right thing" means is key to starting the change in public perception.

In short, if we are going to fix the trust deficit, we need to focus on developing a deeper understanding of our clients and their goals, dedicate the time to learning their values and priorities, and then ensure they are at the center of our focus.

The Role of Financial Market Infrastructures in Rebuilding Trust

While each of us has a responsibility to help in this effort, I believe that financial market infrastructures, or FMIs, have a particularly important role to play in rebuilding trust. Let me turn to my second point and explain what I mean.

Although FMIs come in many shapes and sizes and have varying incentives based on different operating models, competing priorities, and business objectives, we all share a common goal – to monitor, manage, and mitigate risk in all its forms in order to protect the stability of the marketplace and the integrity of the financial system.

At the most basic level, I believe responsible risk management with appropriate regulatory oversight is the key building block to winning back the public trust. Therefore, arguments around how FMIs structure their financial resources or interact with the public will be meaningless if markets are not stable and resilient and if the public lacks confidence in the services we offer.

Among the many FMIs serving the industry, DTCC plays a unique role. We are user owned and governed. Our Board of Directors and our shareholders are also our clients. The funds that back our clearing activities and our ongoing operations come from this same group -- and this group is depending on us to provide a variety of services that are critical to their core business activities. Without our clients, DTCC cannot operate. And without DTCC, our clients cannot serve their own clients.

This relationship ensures that our interests and objectives are completely aligned with our clients, who are also the firms whose capital and core business is on the line at DTCC. It also ensures that our primary focus is on addressing industry needs and protecting market stability, especially during the critical time of a crisis.

In addition, DTCC has very strong governance around our risk management practices. We believe in active, ongoing dialogue with our owners and clients around our risk management structures and policies. We are also highly regulated by multiple regulators and in multiple jurisdictions.

Global financial regulators must have real transparency into the risk management practices of all FMIs, particularly systemically important FMUs like DTCC and other CCPs. That said, we caution against an overheated public debate about CCPs as being too-big-to-fail. Financial regulators have been rightly focused on the value of clearing in reducing risk, and they are also right to ensure that CCPs take on this increased activity with proper risk management and adequate financial resources.

Regulators and legislators, however, cannot adopt a one-size-fits-all approach to CCP oversight, and overly prescriptive requirements could easily have unintended consequences on market structure. Instead, regulators and CCPs need flexible tools for addressing the myriad of risk management issues that CCPs face in today's evolving markets.

Transparency and thoughtful, coordinated, regulatory oversight are the keys for ensuring that DTCC and other critical FMIs are able to play the right role in reducing systemic risk and restoring confidence in the global financial markets.

Stability, Transparency and Resiliency

We believe that the critical role we play, with our unique structure at the center of market activity, gives DTCC an added responsibility and opportunity to help restore investor confidence. So let me turn to my third point on enhancing transparency and increasing resiliency.

At DTCC, we're driving innovation in our core businesses as well as developing new integrated solutions to address current and emerging industry challenges. We are also pursuing initiatives by leveraging our scale and expertise and, at times, we are collaborating with FMIs or firms to take advantage of each other's unique strengths, capabilities and expertise. However, the common thread that connects all these initiatives is that they are all intended to make the financial system more stable, more transparent and more resilient. I want to highlight several cases where we are focusing our efforts in these areas.

Transparency

Our Global Trade Repository (GTR) and Global Markets Entity Identifier (GMEI) are examples of how we are bringing greater transparency and risk mitigation to financial markets and helping regulators better understand exposures in the OTC derivatives market and the build-up of risk in the system. These initiatives also underscore the benefits of our utility model – for the GTR, we make data available to the public free of charge and provide more detailed information to regulators…and, for GMEI, information is stored in a public database and available to all at no cost.

Additionally, our plans to provide central clearing services for the approximately $1.6 trillion institutional tri-party repo market will give regulators a broader and more comprehensive view of the marketplace. This lowers the risk of a liquidity drain in the event of a dealer failure and could potentially prevent another financial crisis like in 2008 when the funds stopped lending to the dealers after Lehman failed.

Resiliency

Market resiliency is critical to ensuring the stability and integrity of the system, and this issue has become even more prominent in recent years as systemic shocks seem to occur with greater frequency than ever before. We take an intentionally broad view of risk management at DTCC, allowing us to focus on traditional and not-so-traditional forms of risk, including credit, market, liquidity, systemic, operational, and other risks that could impact us, our clients and the marketplace.

For example, cyber risk is an area not traditionally associated with DTCC, but we have become very active in combatting this problem because we have both the expertise and the technology to make a difference. We are all aware of the threats posed by cyber criminals. The news is filled with stories of how cyber risk is threatening all industries – from the data breach at Target to the attempted infiltration of NATO's key systems and more recent attacks on ATM machines.

Financial services remains one of the most heavily targeted industries globally, and the reality is that a cyber attack has the potential to take down the largest financial institutions in an instant – just like being hit by lightning. DTCC and the Financial Services Information Sharing and Analysis Center (FS-ISAC) recently launched a new joint venture, known as Soltra, to help critical infrastructures harden their defenses against cyber crimes. This public-private partnership is founded on the principle that information sharing is the key to successfully protecting against attack.

Shortening the Settlement Cycle in the U.S.

Another initiative we're helping to lead will mitigate risk by shortening the US settlement cycle to T+2. We took a giant step forward last year when major organizations like SIFMA and the ICI endorsed the initiative. The industry has since formed a steering committee and working group to identify and execute a plan to implement the business and rule changes required to achieve T+2 in a timeframe that is acceptable for the industry.

In 2015, we hope to complete a list of industry-level requirements and develop a proposed timeline for implementation. Following that, this information will be socialized more broadly, we will engage regulators on proposed rules changes and we will begin planning for testing and implementation of the shortened settlement cycle.

Finally, I want to highlight our Risk Transformation Initiative because this multi-year effort will bring our risk management technology to world-class levels. It is an excellent example of how we invest in risk management as part of our continuing commitment to ensuring market resiliency.

Closing

The nature of risk has evolved in recent years, and we have kept pace by transforming our risk management practices and placing a greater emphasis on identifying, monitoring, and mitigating both the traditional and newer forms of risk that could impact financial stability.

I want to reinforce the importance that a stronger and more secure financial system is the foundation upon which the industry can begin to rebuild trust with the public. Ensuring the safety and soundness of financial markets and financial institutions is the first step on the road to closing the trust deficit. And certainly, we also need to listen to our clients better and always, always act with integrity.

We all have a responsibility to help restore the reputation of the industry. This should be a top priority for all firms because trust is the currency of business – and trust is critical to ensuring the long-term viability of the industry and creating long-term growth for firms. We look forward to working with all of you, and with our colleagues across the industry globally, on this in the months and years ahead. Thank you.