

**BRIAN WILLIAMSON'S SPEECH TO THE
"ICO WORLD COFFEE CONFERENCE"**

FRIDAY 18th MAY 2001

Introduction

I am extremely grateful to the International Coffee Organization for the opportunity to address you at this important event today. I am sure that during the course of this conference there will be many discussions focusing on the current market headlines; in particular the fact that current Robusta and Arabica coffee prices remain close to 30-year lows. While I cannot offer any insight into the potential for a change in fortunes in the coffee market, I can certainly relate to an environment where sentiment is at its lows – this is the position in which LIFFE found itself as recently as two to three years ago. Planning to regain what has been lost is one thing, implementing it is quite another, and it is encouraging to see so many of the leaders of the coffee industry here today, looking to develop directions for the future.

Since I cannot claim to be an expert in the coffee field (pun intended) I will use the next fifteen minutes or so to give you an overview of how world markets, whether commodity, equity or financial, are being shaped by increased technological

application, and to explain the ways in which LIFFE has responded to the challenges posed by these developments.

At this point I should say that while my view has been formed predominantly in the light of the reinvention of the LIFFE futures market, I believe that it is relevant to futures markets generally, as well as to stock exchanges. That may not, of course, be a universally held opinion.

The Competitive Environment

Quoting Bob Dylan (that well known coffee market commentator) “The times they are a changing....”. In fact the changes, and the speed with which they are taking place, are unprecedented.

Local monopoly is being swept away by fierce competition. New exchanges and alternative trading systems are bringing a new dimension to competition as the costs of entering the exchange business are driven lower than ever before. The holy grail – the globalisation of exchange markets - is changing from rhetoric to reality, and the very concept of an exchange is being challenged and redefined.

The cause of all of these developments can be summed up in one word: technology. Just as the telegraph changed the

markets of the Nineteenth Century, and the telephone overhauled those of the Twentieth, so information technology is revolutionising the markets of the Twenty-first Century.

Technology is handing a whole host of new benefits to the investor and the professional intermediary. Access to exchange-traded markets is becoming cheaper, more efficient, more international and more flexible than ever before. This means better service for existing users and a chance for others to access those markets for the first time, giving rise to a greater choice of investment and risk management opportunities.

On the other side of the coin, the same technology is presenting stiff challenges to the exchanges themselves. Technology and downward pressure on costs are causing market users to ask themselves what it is that an exchange has to offer. The emergence of the “bulge bracket” firm and internalisation of order flow, mean that a small number of huge firms now exhibit the characteristics of exchanges. Indeed, one might argue that they are the first wholly international, electronic exchanges.

Comparisons are increasingly drawn between exchanges and these “technology-rich” alternative trading systems and Electronic Communications Networks, which are able to replicate, at low cost, the execution facilities which have

traditionally been provided by exchanges alone. On the face of it these comparisons are valid, but they miss one vital point – the fragmentation of liquidity is not usually in the best interests of the customer.

The comparisons also fail to grasp one of the fundamentals that the commercial ‘coming of age’ of the internet has taught us – that sole ‘product ownership’ in an internet world, where information and access are freely available to all, is impossible to maintain. Far better then to combine the markets in one central hub, and to allow the customer to access them in the way that best suits their business.

So, rather than becoming more entrenched in an attempt to protect their franchises, the challenge for established exchanges is twofold. The first is to capitalise on their core strengths as trusted operators of safe and secure markets, in which users have confidence that they can trade at a fair price. The second is to become “technology-rich” themselves and establish liquidity enhancing partnerships with those who would be potential competitors (for want of a better word).

LIFFE has had to embrace this new environment quicker than most simply because we did not adapt quick enough in the early stages. What made us change was the result of the cost and

efficiency pressures that the major international firms who are present in London were feeling. Inevitably these pressures fed through to the Exchange and made us re-evaluate our role going forward.

As well as being the catalyst for reinventing LIFFE, I hope that our experience will prove to be a salutary tale for others in the exchange business. LIFFE may have been the first house to catch fire but, if the lessons from that experience are not heeded, it will not be the last.

Importantly, as much of the change that has already taken place is cultural as it is technological. For LIFFE, having the technology was one thing but we also needed to implement a fundamental change in our day-to-day operation for the technology to make its mark.

The critical process of cultural change began in 1998 when we restructured the organisation into a commercial, for-profit business aimed at meeting the needs of our customers more efficiently and more effectively than our competitors. We did so because we were convinced that we would only be able to maximise the true potential of the business with an explicit profit motive.

This reform was felt at all levels – down to what some considered the core of the exchange – the severing of the link between seat and share ownership. This model – the traditional exchange template – simply was not able to support the development of a modern electronic market, where widespread distribution and the ability to adapt fast to an ever-changing environment is paramount. It also tends to exclude all but members of the market from owning shares in the exchange.

The cultural change has perhaps been felt most in the way we run our business – entirely commercial as opposed to ‘not for profit’. Opening up the ownership of an exchange to outside investors (regardless of whether they are members or not) imposes commercial disciplines, and in order to deal adequately with the investor’s desire for a return on that investment, I believe an exchange needs a structure that is identical to that of a conventional profit-driven company.

As we have done at LIFFE, I believe that many exchanges will have to start with a blank sheet of paper in order to design an ownership structure that can properly support a “technology-rich” exchange.

LIFFE, The “Technology-Rich” Exchange

So, what exactly does it mean to be a “technology-rich” exchange? Fundamentally, I believe it means a willingness to pick the best technology – regardless of who owns or operates that technology – to deliver the best service.

We at LIFFE believe we have done so, with LIFFE CONNECT™, our electronic trading system. Recent announcements by LIFFE in connection with the Nasdaq Stock Exchange as well as Market Touch – a wholly new venture in retail equities – demonstrates that others share our view.

The current and future success of LIFFE is dependent on excellent service delivery in a number of key areas. I will focus for a moment on two - technical functionality of the trading system and secondly, distribution and access.

Functionality

First, let us take functionality. At the centre of LIFFE CONNECT™ is a highly resilient and flexible trading engine that can be expanded to cope with increased volumes and demand. It is capable of consistent, high-speed order matching; and it is robust enough to operate effectively during fast markets and peaks in trading. Indeed, for those who remain sceptical of

the ability of electronic trading systems to cope with such events, it is notable that just two weeks ago, LIFFE CONNECT™ handled almost two million contracts in one day – just 21,000 lots away from the existing record for LIFFE, dating from the days of open-outcry.

The system has been designed to be sophisticated enough to trade any exchange-traded product, regardless of complexity. The most complex products – particularly those which actively trade multi-month positions, such as commodities and interest rate futures – need to be supported by functionality that delivers the right type of market to the trader. For instance ‘implied pricing’ has allowed us to deliver markets where outright prices and those created by spread trades create the ‘best’ and deepest markets.

This enables LIFFE to offer - on one electronic platform - more derivative products than any other electronic exchange, with commodities such as coffee, cocoa and sugar, being traded alongside bonds, equities and money market instruments.

In fact on a specific coffee note for a moment, the market is telling us that the depth of liquidity that has been created in London by the implementation of LIFFE CONNECT™ on the Robusta Coffee contract, has been a real improvement for the

market. It is just this type of advance that we are looking to deliver through our commitment to technology and the functionality it delivers.

Distribution and Access

Moving on to distribution and access, great efforts have been made to make it easy and cheap for members – and, through them, customers – to use LIFFE’s markets at the touch of a button.

Access is offered through the user’s own workstations, via a wide choice of front-end trading applications, so that the specific needs of the user can be met, whether he/she is a broker, proprietary trader, or market maker. The same is true of electronic order routing facilities that are provided by third party suppliers and used by firms and end customers.

In recognition of the global nature of most of the markets we are involved in, great efforts have been made to facilitate access to LIFFE CONNECT™, on an equal footing, virtually regardless of location. That meant LIFFE partnering with providers of global communications networks - in our case Reliance - to enable access to the trading system from almost any location. You may be interested to know that this is the same network

used by the worlds' airlines to run their reservations and ticketing.

As a consequence, for those who are entitled to direct access to the system, whether you are in central London, the Far East or the USA, you can be assured that you have equal access. Indeed, LIFFE CONNECT™ is now accessible electronically from forty-six cities in twenty-three countries in all three of the major time zones.

Transition to LIFFE CONNECT™ - the LIFFE Robusta

Coffee contract

Clearly, for LIFFE, creating an electronic exchange was not just about shifting trading activity from the market floor to a computer screen. Before LIFFE CONNECT™ could achieve its true potential it was essential to prepare the ground properly and ensure delivery of the required service.

This was the key factor enabling a successful transition to trading on LIFFE CONNECT™ for all LIFFE's products, including the Robusta Coffee contract. We are still in the early stages of the migration of LIFFE's Non-Financial Products from open-outcry to LIFFE CONNECT™, which took place in November last year. Nevertheless, our members and customers continue to tell us that they are very pleased with the way

Robusta Coffee is trading on the system, so much so they are suggesting we look at the opportunities to launch complementary products.

Their confidence in the contract and in LIFFE CONNECT™ is also reflected in the fact that during the past three months we have repeatedly notched up all-time records in open interest - reaching a high of 93,156 contracts during the first week of May. This has strengthened LIFFE's position as the world's leading Robusta Coffee futures market.

e-commodity markets

The advance in technology is, however, not confined to futures markets. Physical commodity markets have seen the creation of internet-based exchanges whose aim is to centralise and reduce the cost of trading the underlying product. Coffee in particular has seen a number of such developments.

These markets have the potential to create deep new pools of liquidity for the markets they serve and to reduce the cost of trading and processing in a way that has not been achieved before.

Naturally it is too early to speculate on winners or losers at this stage but one thing is certain – technology will create efficiency

here just as it has in the derivative markets. It is not inconceivable to imagine a time when physical and futures markets sit alongside each other and clear through the same clearing organisations. In fact this is probably the most important capital efficiency such markets could offer.

Conclusion

In conclusion, we are all facing changes in every facet of what we do – in fact our understanding of our businesses is being challenged on a daily basis. Fighting this is a recipe for disaster. Embracing change is essential for our survival and the development of our industries and allows us to deliver a vibrant future to those that follow us but the results can be slow in coming. In other words times are changing but change can take time.

I would like to leave you with a quote from Burke that perhaps provides a balance to the views that I have expressed today. He commented that that the common dispositions of the greatest part of mankind are “to complain of the age we live in; to murmur at the present possessors of power; to lament the past; and to conceive extravagant hopes for the future”.

Extravagant? I hope so.....