WORLD FEDERATION OF EXCHANGES

Response to IOSCO Consultation Report "Evolution in the Operation, Governance and Business Models of Exchanges: Regulatory Implications and Good Practices"

3 July 2024

Background

Established in 1961, the WFE is the global industry association for exchanges and clearing houses. Headquartered in London, it represents the providers of over 250 pieces of market infrastructure, including standalone CCPs that are not part of exchange groups. Of our members, 36% are in Asia-Pacific, 43% in EMEA and 21% in the Americas. The WFE's 87 member CCPs and clearing services collectively ensure that risk takers post some $1.3 trillion (equivalent) of resources to back their positions, in the form of initial margin and default fund requirements. The exchanges covered by WFE data are home to over 55,000 listed companies, and the market capitalization of these entities is over $111tr; around $124tr in trading annually passes through WFE members (at end-2023).

The WFE is the definitive source for exchange-traded statistics and publishes over 350 market data indicators. Its free statistics database stretches back more than 40 years and provides information and insight into developments on global exchanges. The WFE works with standard-setters, policy makers, regulators and government organisations around the world to support and promote the development of fair, transparent, stable and efficient markets. The WFE shares regulatory authorities' goals of ensuring the safety and soundness of the global financial system.

With extensive experience of developing and enforcing high standards of conduct, the WFE and its members support an orderly, secure, fair and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise the common good, consumer confidence and economic growth. And we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in a globally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

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Response

The World Federation of Exchanges (WFE) welcomes the opportunity to respond to questions raised in the IOSCO Consultation Report entitled "Evolution in the Operation, Governance and Business Models of Exchanges: Regulatory Implications and Good Practices" (the Report)[1]. As representatives of established, regulated, and trusted exchanges we wanted to offer our views on the state of current market structure. Naturally, we focus on those questions that are most relevant to our membership.

In our response, we find that the six Good Practices set out in the Report are largely unobjectionable to the WFE except as noted below. Nevertheless, the WFE reiterates that regulated markets, whether demutualised or not, adhere to a higher standard than other types of markets, including venues that may compete with regulated markets and new entrants which are seeking the imprimatur of being overseen by the same entity that oversees regulated markets while at the same time seeking a lighter regulatory burden. We also wish to reiterate that WFE regulated exchanges currently disclose and manage many of the risks and challenges raised in this Report in those cases where any of the risks and challenges occur.

The WFE welcomes IOSCO's focus on market structure and its decision to update its previous reports on Exchanges and Market Structure. The WFE looks forward to working with IOSCO on updates to its 2001, 2006, 2011 and 2013 reports and on any new topics which IOSCO chooses to explore.

General Responses

Although there were no specific questions about the content of either the Executive Summary or Chapter 1 of the Report, the WFE reiterates that not only for-profit, equity Exchanges, Exchange Groups (EGs) and Multinational Exchange Groups (MEGs) must manage conflicts. The WFE supports the statement in the Executive Summary of the Report that other types of trading venues and those venues trading in other classes of financial instruments may find the Report relevant. We would add that the Report is relevant to all exchanges, whether demutualised or not, as well as to entities that are not formally an exchange, or a self-regulatory exchange (SRO) in their regulatory environment. The relevance of the Report is also true, where applicable, whether an exchange is part of an EG or a MEG or not. Consequently, IOSCO should reconsider its analysis and the Report to determine whether the risks that it cites are common to these other forms of trading venues, and if so, should revise the Report accordingly.

The WFE notes that the causality implied in the Executive Summary, that the transformation of exchanges from mutual ownership to for-profit entities causes or contributes to increased competition, technological advancements, and the emergence of new types of trading venues, may be reversed in some jurisdictions where the transformation of exchanges was in response to some or all of the listed events, as is noted in Chapter 1.

The WFE also takes issue with the Statement in Chapter 1 that data and technology services are new business lines for exchanges. Market data, and the technology necessary to transmit that data, have been part of exchanges' businesses since at least the introduction of the telegraph in the mid-19th century. Exchanges have improved their technology offerings and increased the distribution of their data dramatically over the ensuing centuries.

Responses to Specific Questions

Question 1: Do you agree with the analysis provided and the trends identified in Chapter 2?

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[1] *The consultation can be found at:* *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD763.pdf*

The position of the WFE is that it is imperative to understand the decision-making process underlying whether an exchange is demutualised since it is the exchange's members and owners, not the exchange itself, which have the power to make the demutualisation decision. The WFE represents exchanges, whether demutualised or not. In discussions with our exchange members about their owners' decisions on whether to demutualise the exchange, the WFE typically finds economic and/or regulatory factors are in the forefront of the decision. Understanding the motivation for the decision to demutualise or remain mutual is important for understanding the subsequent actions of exchanges whose owners have chosen to demutualise.

A second critique of the analysis is the characterisation of revenue from market data services in Section 2.2 in absolute terms rather than in relative terms. As relevant regulators and supervisors are aware, mergers and acquisitions often occur in the normal course of business for exchanges. A relative characterisation of revenue from market data services would consider mergers and acquisitions, accounting changes and other events. The absolute characterisation of market data revenue could cause a casual reader to erroneously conclude that revenue from market data services had risen for an Exchange, EG or MEG, whether demutualised or not, when it in fact has not.

A third critique is that the role of exchanges' customers as drivers for common technology and lower costs is insufficiently discussed. Exchanges, whether demutualised or not, are highly attuned to their members' and customers' needs.

Fourthly, the WFE has several factual issues with the analysis. Firstly, the implication from Chapter 2, Section 2 is that US domiciled exchanges were the first to demutualise. The Stockholm Stock Exchange is typically cited as the first to demutualise (1993) and there were several exchanges that demutualised before Nasdaq (2000-2001) and the NYSE (2006).[2] A second implication from Chapter 2, Section 3 is that MEGs are a consequence of changes in ownership structure and other recent trends in the industry. Nasdaq Japan was launched in 2000 and Nasdaq Europe in 2001, both events occurring prior to Nasdaq completing its demutualisation process.

Finally, in reference to Table 1 Nasdaq, Inc. does not own or operate either Nasdaq Dubai or Borse Dubai, Deutsche Börse Group does not operate in Hong Kong or Singapore but does operate in Luxembourg. Secondly, Deutsche Börse Group does not operate Börse Berlin, Stuttgart, Düsseldorf, München, Equiduct, the Nordic Growth Market, or BX Swiss. Thirdly, Deutsche Börse Group offers Investment Management Solutions, Fund Services, and Securities Services. Fourthly, it is Japan Exchange Group (not Japan Stock Exchange). Finally, CBOE Global Markets does not offer an EU Systematic Internaliser Service. Table 1 should be updated to reflect these changes.

Question 2: Have you identified other major trends regarding the changes in the business models of exchanges?

For-profit, demutualised exchanges may return capital to their owners/shareholders. This return of capital typically takes the form of dividends or share repurchases and only occurs if an exchange generates capital by successfully creating an ecosystem that serves investors, firms, banks, and other clients. The form of returning capital to owners/shareholders is a major departure from non-demutualised exchanges which typically return capital to their owners/members in the form of lower fees, fee holidays, or other actions all of which result in lower costs, and potentially higher profits, for owners/members. Mutually owned exchanges can have similar risks and challenges as

[2] A list of demutualised exchanges usually includes Sweden (1993), Helsinki (1995), Copenhagen (1996), Amsterdam (1997), ASX (1998), Toronto, Hong Kong and LSE (2000), the same year as the demutualisation of the CME, a US commodities exchange which was the first exchange to fully demutualise in the US.

demutualised exchanges although their owners are also the users. Á mutual owner depends on the exchange and more broadly the market operating efficiently so the mutual owner can maximise their own profit.[3]

Related to our response to Question 5, the role of competition is understated although competition is mentioned in Chapter 2, Section 1. The WFE and its members, whether demutualised or not, welcome competitive discipline and the value it creates for our customers. But the WFE regularly hears from its members that the lighter regulatory burden of members' competitors creates an existential challenge for exchanges and is a primary driver for members embracing EGs and MEGs.

Question 3: If yes, what other factors do you think might have contributed to the additional trends identified?

The primary factor for the first trend is the need for capital investment due to the changes in exchange technology over the past quarter century. Whether investment is required directly by regulators or indirectly through customer demand or the introduction of competition is irrelevant. What is relevant is that the need to obtain capital beyond that which exchange members will provide has driven the demutualisation of a number of WFE member exchanges.[4] Exchanges ultimately obtain capital by creating an ecosystem for serving their users – this is the role of an exchange, to bring together disparate interests and incentives in a fair and orderly manner.

With respect to the second trend, the role of regulation in furthering competition both for trading and for other exchange activities, often creates competitors for exchanges who do not share the same regulatory burden as exchanges. The WFE and its members are concerned that temporary differences in regulation introduced for any purpose may become permanent and exchanges' role as neutral and trusted partners in a jurisdiction's financial infrastructure may be jeopardised.

Question 4: Do you agree with the risks and challenges identified in Chapter 3?

The WFE and its members, whether demutualised or not, work closely with regulators so that the potential risks and challenges listed in Chapter 3 remain potential risks and challenges. The recommendations in the Report seek to maintain the status of regulated markets as neutral and trusted components of a jurisdiction's financial infrastructure. Because there is no current evidence that these risks and challenges are not well managed by Exchanges, EGs and MEGs, the Report should so state, to support the trusted status of regulated markets.

The WFE supports the Report in recommending that exchanges and trading venues expanding their operations into other jurisdictions should notify the relevant regulators to ensure that appropriate regulatory and disclosure measures are taken, or in place. Policy makers and regulators should determine whether exchange regulation or a lighter form of authorisation than regulation is appropriate.

Furthermore, the Examples of Toolkits throughout Chapter 3 should contain the language, which is currently only in Section 3.1.a, that the toolkit examples apply regardless of whether exchanges have demutualised or not. The WFE does not believe demutualisation *per se* causes any of the risks and challenges listed in Chapter 3.

Finally, any proposals based on the Toolkits should avoid overly restrictive additional requirements which would in the end only increase costs for the market and market participants. In some jurisdictions regulators already realise that regulation may have gone too far and needs reduction. Some examples in the Toolkits already seem to go beyond the

[3] See O Hart, J Moore, "The governance of exchanges: members' cooperatives versus outside ownership" Oxford Review of Economic Policy, Volume 12, Issue 4, December 1996, Pages 53–69, https://doi.org/10.1093/oxrep/12.4.53
[4] Ibid.

goal of counteracting identified risks and challenges in the same section. IOSCO should identify whether any examples in the Toolkits are no longer in effect in their jurisdiction.

Question 5: Do you think that there are other risks and challenges that have not been identified?

The WFE notes that the Report does not identify risks or challenges which may arise from the creation of new entities, such as broker/investment firm led trading venues, for example Multilateral Trading Facilities and Systematic Internalisers in the EU, which are more lightly regulated than incumbent exchanges, whether demutualised or not. Some of these new entities compete directly with regulated exchanges as trading venues, some are only potential competitors. Regardless of whether a new entity currently competes with a regulated exchange, the existence of a lighter regulatory obligation and therefore a lighter regulatory cost burden creates incentives for the formation of trading venues, trading venue groups, and multinational trading venue groups. One risk embedded in trading venues set up by brokers, funded by them, and supported by their own order flow, is that often loss-making entities are kept operating for the sake of pressuring competitors' fees. Another risk is the potential for conflict of interest between best execution for the client and profit for the broker/investment firm. The Report does not identify any risks or challenges that might arise from such entities.

Queston 6: Do you have comments on the proposed good practices identified in the boxes in Chapter 3?

The WFE recommends that all three subgroup headings for the proposed six good practices apply to Other Trading Venues as well as exchanges. In the current draft, only the sub-group heading of proposed good practice #4 in Section 3.2 and the associated heading for Examples of Toolkits in the same section include Other Trading Venues.

Similarly, the WFE suggests changing "exchanges" to "trading venues" throughout the text of the six good practices. Currently, only good practice #4 from Section 3.2 and good practice #6 from Section 3.3 refer to Trading Venues.[5] Specific examples of what constitutes a trading venue varies across jurisdictions and ideally should be as broad as possible including, for example, Regulated Exchanges, Multilateral Trading Facilities, Systematic Internalisers, and Organised Trading Facilities in the EU.

The WFE strongly supports Practice 5 and agrees with IOSCO about the importance of mechanisms to facilitate and support supervision and supervisory cooperation across jurisdictions. Examples cited by the Report include ad hoc cooperation, MOUs, supervisory colleges, and regulatory networks. The many issues encompassed in extraterritoriality cannot be resolved by the WFE or even by IOSCO. Consequently, bilateral or multilateral means such as those mentioned in the Report are the best means available.

It is important to highlight that there should not be duplication in requiring submission of audited financial statements and/or budgets to regulators for public exchanges since they already may have similar or identical obligations as publicly listed companies. In addition, any requirement for regulatory approval for intra-group outsourcing must balance any benefits from the regulatory approval against any costs arising from a slower time-to-market in a rapidly evolving market environment. The WFE notes that many exchanges are already held responsible for the development and sourcing of core functions and may face consequences should problems arise.

Finally, the Report's good practices are largely practices that regulatory authorities in a number of jurisdictions globally already employ in their oversight of exchanges that are part of a larger corporate group. For such regulators these are not new practices that need to be adopted for adequate supervision and thereby do not necessitate a change by regulators.

[5] The reference to trading venues in good practice #6 does not also appear in the sub-section heading for good practices #5 and #6.

Question 7: Do you have suggestions regarding other good practices and/or examples of toolkits to be included?

The WFE recommends that two of the core principles of regulated exchanges, those of neutrality and isonomy, should be extended to all types of trading venues to maintain public faith in the markets, even though some types of trading venue may be governed by different regulations than exchanges. We also support regulations which enforce common transparency and equal access requirements across different types of trading venues.

The WFE has nothing further to add with respect to other good practices or toolkit examples.

Conclusion

The WFE welcomes the Report and applauds the efforts of IOSCO to keep regulators and policy makers abreast of the evolution of regulated markets. We feel that the Report places too much emphasis on demutualisation of exchanges and consequently, IOSCO should reconsider its analysis and the Report to determine whether the risks that it cites are common to other forms of ownership and types of trading platforms, and if so, should revise the Report accordingly. We share with IOSCO the belief that regulators need to understand the causes, risks and challenges that may arise from the emergence of multinational and domestic groups of exchanges and/or trading venues, but we also note that the good practices are largely practices that many regulatory authorities globally already employ and that these are not new practices that need to be adopted for adequate supervision and thereby do not necessitate a change by many regulators. Finally, we look forward to working with IOSCO on future market structure projects particularly those related to cooperation between regulators.