

Principles for the Governance of Market Infrastructure

An efficient and competitive market infrastructure plays a unique role in the capital market as it contributes to the efficient allocation of capital and higher rates of economic growth, thereby directly affecting millions of investors and thousands of companies. For that reason ICSA members consider that the recent evolution of exchanges and clearing and settlement systems, many of which have undergone radical changes in their corporate structure during the past decade, raises important public policy issues.¹ In particular, during this period almost all of the world's major exchanges and many smaller exchanges have demutualized and, as result, are no longer member owned cooperative organizations but investor owned, profit-oriented and, in some cases, publicly listed companies.

The response to the dramatic changes in the corporate structure of these market infrastructure providers has differed between jurisdictions.² Much of the debate in the U.S. occasioned by the demutualization of the New York Stock Exchange, for example, focused on the potential conflicts of interest between the exchange's commercial and regulatory activities. At the international level, IOSCO examined this same issue in a consultation report that looked at the evolution of exchanges.³ In Europe, on the other hand, this particular concern is less of an issue. Instead, concerns in Europe are focused

¹ The members of the International Council of Securities Associations (ICSA) represent and/or regulate the overwhelming majority of the world's equity, bond and derivatives markets. ICSA's objectives are: (1) to encourage the sound growth of the international securities markets by promoting harmonization in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members. A list of ICSA members is attached to this document.

² The principles set forth in this document address the recent evolution of exchanges and clearing and settlement systems. These entities provide infrastructure services for the trading of securities and derivatives and are referred to collectively as market infrastructure providers for the purpose of this document. The principles set forth in this document would also apply to alternative exchanges such as ATs and ECNs when those systems have significant market share.

³ See IOSCO Technical Committee, *Regulatory Issues Arising From Exchange Evolution* (March 2006).

primarily on competition issues, including the impact of the vertically integrated or “silo” systems,⁴ and on potential conflicts of interest between users and shareholders. Strikingly, almost none of those issues were clearly identified or anticipated at the time of demutualization.

The consolidation of market infrastructure providers both nationally and internationally is likely to continue and may even intensify in the near term. Continued consolidation should in theory bring with it a variety of benefits, including more integrated and liquid markets and lower costs for users. Demutualization and ongoing consolidation, however, heightens concerns that a small number of market infrastructure providers may emerge as dominant players in a number of markets, leading to the potential for monopolistic pricing and other forms of uncompetitive behavior, which in turn would have a negative effect on capital formation and the overall efficiency of the economy.

In cases where market infrastructure providers have dominant or monopolistic market positions, ICSA members believe that the relevant authorities should take appropriate policy measures to promote effective competition for those entities. If such a policy response is not possible or practical, the relevant authorities should take steps to ensure that appropriate governance structures and rules are in place so that the interests of users, the investing public and the economy as a whole are protected.

In the light of these concerns, ICSA members have developed a set of *Principles for the Governance of Market Infrastructure* intended to provide a framework for the implementation of governance arrangements at market infrastructure providers that would reflect the unique characteristics of the industry and ensure accountability and transparency for owners, users and regulators. The Principles are based on the understanding that efficient and competitive market infrastructure providers play a vital role in national and international capital markets, and are intended to ensure that market

⁴ The organization of clearing and settlement activities has been the focus of a great deal of attention over the past several years in Europe where two business models have emerged: (1) the horizontal model where trading activities are managed separately from clearing and settlement activities, and (2) the vertically integrated or “silo” model, where trading, clearing and settlement activities are all carried out by one organization. The impact of vertically integrated systems on competition within Europe is a particular source of concern and there are also doubts about the compatibility of the vertically integrated model with the emergence of horizontal pan-European post-trading infrastructures.

infrastructure providers continue to play that special role effectively, despite the pressures imposed by demutualization and consolidation.

Implementing these Principles or similar arrangements will require not only the support of the different interested parties, but also that of the relevant authorities. Whenever possible these or similar principles and related arrangements should be incorporated into the articles of association or by-laws of the market infrastructure providers.

Accordingly, ICSA members propose the following set of Principles for the Governance of Market Infrastructure:

1. The overall objective of market infrastructure providers should be to **promote greater efficiency** for the benefit of all market participants **by reducing the costs of trading, clearing and settlement services** and introducing **innovations** tailored to users' and customers' needs, including issuers, while **complying with applicable risk management and regulatory requirements**.
2. Market infrastructure providers must be **transparent** both in their governance arrangements and in their financial and business operations.
3. Market infrastructure providers must **allow qualified users fair and non-discriminatory access to the systems**.
4. Market infrastructure providers must maintain **impartial and transparent pricing** to ensure that fees are properly related to costs and result in a fair charge to market users.
5. Market infrastructure providers should ensure that **users have a strong and effective voice in their governance** . In particular, users must be consulted in advance about contemplated changes in tariffs, business terms and development projects, and, more generally, must be able to influence the range and quality of services provided by the market infrastructures.

6. There must be an **effective separation between trading platforms and clearing and settlement systems**, and users must have fair and non-discriminatory access to these different services. An effective separation would require that trading platforms and clearing and settlement systems were either owned and operated separately or, if owned by a single entity, operated as rigorously divided subdivisions with separate management, separate audited accounts and transparent relationships. The separation of activities is necessary in order to ensure that the risks of hidden cross-subsidies and other forms of unfair competition are adequately controlled. In addition, arrangements must be in place to ensure that market infrastructure providers do not take unfair competitive advantage of their central position or their regulatory role, particularly when providing value-added services.
7. Since market infrastructure providers are likely to benefit from having a **dominant or monopolistic market position**, appropriate **rules** ensuring the effective application of these Principles should be defined and implemented under the **surveillance** of the relevant authorities. In particular, principles for the sharing of benefits between users and shareholders should be defined in advance in an appropriate manner. If necessary, such principles should be subject to approval by the relevant regulatory and/or governmental authorities.
8. Cross-border consolidation of exchanges should not weaken the **link between the market infrastructure providers and local market participants**, including issuers, intermediaries and investors, large and small. This link is particularly important in a number of areas, including: (a) rules for market access, listing and trading; (b) surveillance arrangements; (c) index composition; and, (d) the design and implementation of technical systems.
9. Market infrastructure providers may retain their regulatory functions, depending on the jurisdiction where they are domiciled. However, in such cases market infrastructure providers should ensure that their **regulatory operations are transparent and that the potential for conflicts of interest between their commercial and regulatory activities is addressed** through

appropriate structures, policies and procedures. Those structures, policies and procedures should be approved by the relevant regulatory authorities.

10. In light of the dramatic changes that exchanges and clearing and settlement systems are experiencing at the national and international level, **information sharing and other collaborative arrangements** between regulatory and supervisory authorities regarding market infrastructures should be strengthened. Market infrastructure providers should collaborate with and actively support such efforts.