

June 2, 2006

Mr. Philippe Richard
IOSCO Secretary General
Oquendo 12
28006 Madrid
Spain

Re: **Public Comment on *Regulatory Issues Arising from Exchange Evolution***

Dear Mr. Richard:

We are writing to you in our capacities, respectively, as Chairman of the Working Group on the Governance of Market Infrastructures of the International Council of Securities Associations (ICSA) and the Secretary General of ICSA.¹ This Working Group, which is composed of trade associations and SROs from all over the world, has been examining a number of issues related to recent changes in the corporate structures and governance arrangements of market infrastructures, including demutualized exchanges. We support IOSCO's initiative on this issue and urge IOSCO to continue to examine the ramifications of exchange demutualization and consolidation.²

Exchanges play a unique role in the economies where they are located as they facilitate the development of a deep and liquid secondary market, which in turn provides transparent market prices for capital market financing and thereby contributes to the efficient allocation of capital. A deep and liquid secondary market promotes the growth and development of a vibrant primary market. In short, a well functioning and efficient exchange is critical in a

1. ICSA is composed of trade associations and self-regulatory associations for the capital market in broad range of jurisdictions as well as a number of international trade associations. ICSA members represent and/or regulate the firms that carry out the bulk of the activity on the world's equity, bond and derivatives markets. A list of ICSA members is attached to this letter.

2. A separate ICSA Working Group is sending a comment letter on the report's conclusions regarding the regulatory role of exchanges.

market economy for effective capital formation and economic growth. For that reason the recent evolution of exchanges – which have gone from being member-owned cooperative organizations to privately owned, profit-oriented and in some cases publicly listed companies – raises important public policy issues.

One particular area of concern, from a public policy point of view, is the emphasis that the demutualized exchanges place on profit maximization for shareholders. In theory, profit maximization leads to efficient outcomes when markets are competitive. However, that is not necessarily the case for exchanges, in part because of the unique role that these institutions play in the economy. Indeed, as was noted in the IOSCO report, competition between exchanges may lead to suboptimal outcomes. In addition, as was also noted in the IOSCO report, over time exchanges and other market infrastructures often evolve toward highly concentrated and even monopolistic market structures.³ When exchanges have no effective competition, they are free to utilize their market power in order to increase the fees that they charge to the firms and individuals that use their products and services. Higher fees and other forms of uncompetitive behavior, in turn, may have a negative effect on capital formation and on the overall efficiency of the economy.

For all of these reasons, the ongoing process of demutualization and consolidation between exchanges, on both a national and international level, intensifies concerns that a small number of exchanges will eventually have monopolistic or quasi-monopolistic market positions in a large number of jurisdictions which they can exploit to the detriment of market efficiency. Therefore, the members of the ICSA Working Group on the Governance of Market Infrastructures strongly support Recommendation 5 in IOSCO's report, which states that, "regulatory authorities should consider competition issues that may arise in connection with the evolution of exchanges...where such evolution impacts market integrity, efficiency or investor protection."

In response to concerns raised by the demutualization and consolidation of exchanges, the members of ICSA's Working Group on the Governance of Market Infrastructures have

3 This is particularly the case for exchanges that offer both trading and post-trading services.

developed a set of Principles for the Governance of Market Infrastructures. These Principles are currently being discussed by the broader ICSA membership and therefore cannot yet be distributed. We would note, however, that the Principles are intended to provide a framework for the implementation of governance arrangements at exchanges and other market infrastructures in order to promote greater efficiency and increased transparency in the operations of those organizations. In particular, the Principles seek to ensure that all users have a strong and effective voice in the governance of exchanges and other market infrastructures, that exchanges' regulatory operations are transparent and that potential conflicts of interest between the exchanges' commercial and regulatory activities are managed through appropriate structures, policies and procedures. Moreover, in light of the ongoing consolidation between exchanges, the Principles are also intended to ensure that the link between market infrastructures and local market participants is maintained and the information sharing and other collaborative arrangements between regulatory and supervisory authorities regarding market infrastructures are strengthened.

In closing, we would like to thank the members of Standing Committee 2 for the work that they have done in preparing their report on *Regulatory Issues Arising from Exchange Evolution*. It is an extremely timely and relevant report and we would urge IOSCO to continue to focus on this issue.

Sincerely,



Pierre de Lauzun, Chief Executive
French Association of Investment Firms (AFEI)
and Chairman, ICSA Working Group on the
Governance of Market Infrastructures



Marilyn Skiles
Secretary General
ICSA

The members of ICSA are as follows:

Association of Capital Market Intermediary Institutions of Turkey (TSPAKB)

Association of French Investment Firms (AFEI)

Association of Italian Financial Intermediaries (Assosim)

Australian Financial Markets Association (AFMA)

Bond Exchange of South Africa (BESA)

Bond Market Association (TBMA)

International Capital Market Association (ICMA)

Investment Dealers Association of Canada (IDA)

Japan Securities Dealers Association (JSDA)

Korea Securities Dealers Association (KSDA)

London Investment Banking Association (LIBA)

NASD

Securities Industry Association (SIA)

Swedish Securities Dealers Association (SSDA)

Taiwan Securities Association (TSA)