DEMUTUALIZATION
OF STOCK EXCHANGES
TRENDS AND ISSUES
ROLE OF REGULATORS

Iñigo de la Lastra
Deputy Director Secondary Markets
Directorate
Markets General Directorate
Disclaimer (*)

(*) The author is the sole responsible of the content and the views expressed in this presentation. In no way the opinions expressed herein can condition the criteria or the decisions that, on these and other issues could be adopted in the future by the Comisión Nacional del Mercado de Valores
An exchange’ demutualization is an evolving process from a non-for-profit member-owned exchange to a shareholder-owned exchange, which is likely to be a for-profit corporation.
Exchange demutualization produces changes (I)

Main changes that a demutualization process will produce

✓ The decisions will be made in the company on a one share, one vote basis instead of on a one-member, one-vote basis
✓ The owners, decision-makers and direct users of the exchange's trading services could be different persons
✓ Shares of the company will be more freely tradable than the old ownership rights
Exchange demutualization produces changes (II)

- **Main changes ...**
  - It will be possible for the exchange to raise capital from other entities than market participants so favoring the capital increase of the market
  - The entrance of new participants in the exchange will be facilitated
  - To be a market participant will be dissociated and not related to the necessity of being market member or shareholder
Main drivers for demutualization

- Increasing competition
  - Requires more efficiency in all activities
  - Including the decision-making process
- Changes in technology
  - More efficient trading systems require significant investments in new technology
  - There is need for broader access to capital
- Additionally, certain responses to competition
  - Alliances and mergers between exchanges
  - May be facilitated by demutualization
Recent trends of demutualization

✓ In 2000 and 2001 demutualization processes were more frequent than before
✓ The majority of European Securities Markets are currently demutualized
✓ Demutualization processes have been more recently accelerated in the U.S.A.
✓ In most of the cases the demutualization was followed for the listing of the shares
  - Either immediately or after a short period
  - Very often in the exchange's own market
Recent trends

<table>
<thead>
<tr>
<th>Exchange</th>
<th>Demutualization date</th>
<th>Listing date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Helsinki Stock Exchange (OMX)</td>
<td>1995</td>
<td>Integrated in OMX</td>
</tr>
<tr>
<td>Copenhagen Stock Exchange</td>
<td>1996</td>
<td>Integrated in OMX</td>
</tr>
<tr>
<td>Amsterdam Stock Exchange</td>
<td>1997</td>
<td>Integrated in Euronext</td>
</tr>
<tr>
<td>Borsa Italiana</td>
<td>1997</td>
<td></td>
</tr>
<tr>
<td>Iceland Stock Exchange</td>
<td>1999</td>
<td>Integrated in Euronext</td>
</tr>
<tr>
<td>TSX Group</td>
<td>1999</td>
<td>2002</td>
</tr>
<tr>
<td>Singapore Exchange</td>
<td>1999</td>
<td>Nov. 2000</td>
</tr>
<tr>
<td>Nasdaq</td>
<td>2000</td>
<td>Feb. 2005</td>
</tr>
<tr>
<td>Sydney Futures Exchange</td>
<td>2000</td>
<td>April. 2002</td>
</tr>
<tr>
<td>Bolsas y Mercados Españoles (BME)</td>
<td>2000</td>
<td>Jul. 2006</td>
</tr>
<tr>
<td>Deutsche Börse</td>
<td>2001</td>
<td>Feb. 2001</td>
</tr>
<tr>
<td>Oslo Stock Exchange</td>
<td>2001</td>
<td>OTC</td>
</tr>
<tr>
<td>Swiss Exchange (SWX)</td>
<td>2001</td>
<td></td>
</tr>
<tr>
<td>New York Stock Exchange (NYSE)</td>
<td>2006</td>
<td>Mar. 2006</td>
</tr>
<tr>
<td>Bursa Malaysia</td>
<td>2004</td>
<td>Mar. 2005</td>
</tr>
<tr>
<td>CBOT Holdings Inc.</td>
<td>2005</td>
<td>Oct. 2005</td>
</tr>
</tbody>
</table>

Sources: IOSCO and Madrid Stock Exchange
Demutualization raises some key issues to be analyzed for securities regulators

- The adequacy of the regulatory and public interest functions and responsibilities assigned to a for-profit exchange should be analyzed with regard to
  - Potential conflicts of interest between the shareholders (maximize benefits) and market participants (efficient and competitive trading services)
... some key issues to be analyzed ...

- Reduction of the resources allocated for the exchange' regulation and supervision functions
- Potential incentives for softening the level of regulation with regard to
  - Eligibility requirements for listing
  - Trading rules
  - Eligibility requirements for market participants
  - Risk mitigation requirements for clearing and settlement
Key issues for regulators (III)

⇒ ... some key issues to be analyzed ...
✓ Potential threats to the financial viability of the exchange
   • Possible incentives for assuming more commercial risks in its business model
✓ Those problems could be exacerbated if the demutualized exchange is going to be listed
✓ Additional conflicts of interest may appear in case of self-listing
   • Would be appropriate for the exchange to be its own regulator as issuer and its own supervisor for its trading as instrument?
Regulatory responses to the exchanges demutualization

- They have been different and there is not a universal regulatory solution to be followed. It depends on the circumstances.
- Sometimes regulatory legal framework was modified before demutualization arrived.
- In some cases the clearing and settlement activities were transferred to another institution.
Some common regulatory responses to demutualization

- Increasing the scope of statutory regulation and the regulatory oversight
- Transferring the regulatory functions of the exchange to the securities regulator, another independent entity, or a SRO
- Requiring exchanges to have all changes in their rules approved by the securities regulator authority
… common regulatory responses …

- Establishing corporate governance mechanisms and restrictions to shareholding as for instance
  - Appropriate governance arrangements
  - Specific and separate regulatory divisions in the exchange
  - Caps to the quotes of individual shareholders and previous approval requirements for exceeding those thresholds
  - Fit and proper requisites for relevant shareholders
IOSCO (www.iosco.org)

✓ Reports of the Technical Committee
  - "Issues Paper on Exchange Demutualization", June 2001
  - "Regulatory Issues Arising from Exchange Evolution". Responses to the Consultation Report, June 2006

✓ Emerging Markets Committee
  - "Exchange Demutualization en Emerging Markets", April 2005
THANK YOU VERY MUCH
FOR YOUR ATTENTION!