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# **Governance of Market Infrastructure Institutions**

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# Governance of Market Infrastructure Institutions

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## Overview

- 1) Introduction
  - 2) Basic Models
  - 3) Demutualization
  - 4) Complexities
  - 5) Allocation of Regulatory Responsibilities
  - 6) Conclusions
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# Governance of Market Infrastructure Institutions

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## 1) Introduction

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# Introduction

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Governance is about Power

- Who has it?
  - How and why do they obtain it?
  - **How and why do they use it?**
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# Introduction

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## Sources of Power

- Formal Factors:

  - Law

  - Regulation

  - Constitution

  - Contractual Arrangements

- **Informal, Non-Legal and Non-Contractual Factors**

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# Introduction

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## Reasons for Controversy

- Debate about Effectiveness of Different Structures
  - Confusion about Governance in Practice
  - Conflicts of Interest in SROs
  - Legislative and Regulatory Developments
  - Difficulties at Various Institutions
  - Focus on Corporate Governance
  - **Concern about Consolidation and Market Power**
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# Governance of Market Infrastructure Institutions

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## 2) Basic Models

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# Basic Models

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## The Non-Profit Model

- No Distribution of Profits
  - Reasonable Compensation to Management
  - Only Shareholders can Vote
  - “Commercial” “Mutual”
  - **Consumer Surplus Maximisation**
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# Basic Models

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## The Co-operative Model

- Services for Members Only
  - Only Consumers can be Members
  - Only Members can Vote
  - **Consumer Surplus & Producer Surplus Maximisation**
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# Basic Models

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## The For-Profit Model

- Profits can be Distributed
  - Non-Members can have Voting Rights
  - Non-Members can Consume Goods
  - **Producer Surplus Maximisation**
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# Governance of Market Infrastructure Institutions

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## 3) Demutualization

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# Demutualization

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## Merits I

- More Responsive to Customers
  - Modernize Technology
  - More Flexible Governance Structure
  - Currency for Mergers and Acquisitions
  - **Unlock Members' Equity, and Buy them Out**
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# Demutualization

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## Merits II

- Avoid Concentration of Ownership
  - Reward Market Participants with Equity
  - Catalyst for New Business Opportunities
  - Access to Capital
  - **Improve Financial Decision-Making**
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# Demutualization

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## Issues

- Owners want Profits
  - Exploitation of Monopoly where Possible
  - Standard Corporate Governance will not Stop this
  - **Merit of the Mutual Structure**
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# Demutualization

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## Complexities

- Buy Me Out, Please
  - Effects on Linkages
  - **"Successes"**
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# Governance of Market Infrastructure Institutions

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## 4) Complexities

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# Complexities

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## Industry Structure: Sources of Market Power

- Liquidity attracts Liquidity
  - Switching Costs
  - Netting Benefits
  - Collateral Management
  - **Economies of Scale**
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# Complexities

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## Industry Structure: A Short History of European Exchanges

- Single Municipal Exchange
  - Multiple Competing Municipal Exchanges
  - Single National Exchange
  - Multiple Competing National Exchanges
  - Multiple Competing ATSS
  - **Single Pan-European Exchange**
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# Complexities

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## The LCH.Clearnet Example

- **Ownership**  
45.1% Euronext, 45.1% Members, 9.8% Euroclear
  - **Voting Structure**  
Caps: 24.9% Euronext (Balance in Trust), 9.8% Euroclear, 3.0% Individ.
  - **Governance**  
16 Directors - 5 Exchanges (including 4 Euronext, 2 Executives), 5 Users, 1 Euroclear, 3 Independents, LCH.Clearnet CEO, LCH.Clearnet Deputy CEO
  - **Technology**  
Supplier is Atos-Euronext – 50% owned by Euronext
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# Complexities

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LCH Chairman's Requirements for Consolidation:

"any consolidation would need to recognise the value of in-house clearing houses to exchanges as a source of revenue and a means of protecting their products from competition."

- **Key Problem If These are Delivered**
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# Governance of Market Infrastructure Institutions

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## 4) Allocation of Regulatory Responsibilities

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# Allocation of Regulatory Responsibilities

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## Self Regulation: Benefits

- Good monitoring beyond reach of law
  - Practitioners' knowledge and experience
  - Self-regulation brings legitimacy
  - Policies less susceptible to political whim
  - Alternatives not cost effective
  - **More flexible and informal**
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# Allocation of Regulatory Responsibilities

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## Self Regulation: Issues

- SRO may further Members', and not Public, Interest
    - Fraud
    - Monopoly
    - Systemic Risk
  - SRO may supervise Competitors
  - Unfairness
  - **Multiple SROs brings Gaps/Antagonism**
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# Allocation of Regulatory Responsibilities

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## Self Regulation: Mitigating Policies

- Transparency
  - Due Process
  - Diversity of Representation
  - Regulatory Oversight
  - **Conflict of Interest Resolution**
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# Allocation of Regulatory Responsibilities

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## Possible Areas of Public Intervention

- Ownership
  - Voting Structure
  - Corporate Status
  - Board/Committee Representation
  - Transparency
  - **Consultation**
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# Governance of Market Infrastructure Institutions

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## 5) Conclusions

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# Governance of Market Infrastructure Institutions

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## Conclusions

- Governance Matters for Business Development
  - Governance Matters to Regulators
  - Complexities with Different Structures
  - **Range of Commercial & Regulatory Responses**
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