WFE Annual Meeting

Monday 13th October 2008

"Industry Associations: Their Future Role"

Speech by Spyros I. Capralos

FESE President

The financial sector around the world is going through difficult and critical times. If there was ever an instance when cooperation was valuable, it is today!

I will talk about **cooperation through trade associations**. Cooperation can help us not only come out of this crisis but also build safe, sustainable, well-regulated and efficient financial systems. Specifically, I will present the work of the **Federation of European Securities Exchanges**, which is the structure that brings together 42 exchanges active in equities, bonds, derivatives and commodities.

We European exchanges cooperate not only **with one another**, but also with our **Users** and in particular **our Members – banks and brokers -**, as well as with our **supervisors**. **FESE** plays an important role in this cooperation. Today I will talk about some of the priorities of our Federation and how we view short-term and long-term trends.

FESE's work is above all aimed at increasing the **global competitiveness of European exchanges**. We try to achieve this by promoting high-quality regulation in the EU and a level playing field for exchanges around the globe. In policy, we work in many areas from prospectuses to corporate governance, covering every step of the capital markets activities from issuance, trading, and reporting to post-trading.

In almost every file, we seek to work with other stakeholders to achieve our common goals. I'll take **three brief examples** of our recent work to show the importance of cooperation with other associations and Users.

Over the last two years, an important focus of our work has been to ensure **the sound implementation of MiFID.** Towards this objective, we have worked closely with the banking sector and other users to improve a critical proposal from the European supervisors, CESR, to ensure that exchanges and banks used an efficient system **for transaction reporting for derivatives.** Our joint efforts convinced the regulators to allow a so-called "Alternative Instrument Identifier", which saved our Users millions of Euros and safeguarded the efficiency of our sector.

One of our recent initiatives is aimed at **maintaining the high quality and accuracy of securities trading statistics in Europe.** FESE members have sought to continuously improve their common methodology over the years and have recently adapted this to MiFID and to the latest industry developments. Over the last few months, we took the initiative of cooperating with the new execution venues in Europe to work towards a standard for data methodology to be adopted by all venues and to be built around the high-quality standards we have delivered.

FESE's leadership in industry cooperation is also evident in a different field, in **clearing and settlement,** where we have worked with the associations representing the European Clearing Houses -**EACH**- and the European Depositories –**ECSDA**- to introduce a self-regulatory **Code of Conduct** two years ago.
FESE has also coordinated with the Users and European Institutions to ensure a successful implementation of the Code.

So, as you can see, FESE demonstrates a very **collaborative spirit.** This is above all because our members do not see themselves 'as an island on to their own'. They recognise that what happens around them may have a direct impact on their business and their investors.

In fact, **the crisis** provided a major lesson in this regard. The origins of the crisis had nothing to do with exchanges, but in the end both exchanges, their listed companies and the economy were severely affected.
The irony is that the crisis emerged from OTC products and markets that are different from our products and markets.

In particular, the crisis emerged from the use of **complex structured products issued and traded in non-transparent** markets.

As liquidity evaporated, some of these assets became impossible to evaluate. Some of the participants that hold such products and refinance themselves on the market are **not supervised, are not listed and therefore are not subject to mandatory disclosure rules**. Their level of leverage is not precisely known. Moreover, we have seen entities such as **SIVs exposing themselves to high risks without having a solid capital base, any sort of deposit base or regulation securing capital adequacy** equivalent to that of banking institutions. We have also seen the absence of the main ingredient of any well-functioning market: **<u>Information</u>**.

Market participants and rating agencies have **not** been disclosing the potential risks **adequately** or on a **timely basis**.

From the start of the crisis, exchanges helped mitigate the crisis by providing what they have been offering for years: **liquidity, disclosure, transparency and price formation**. During this period of high volatility and uncertainty, exchanges have performed their role well. Many regulators have welcomed the resilience of post-trading infrastructures throughout the most difficult moments.

Still, because of the linkages between segments of the sector and the economy, **everyone is touched by the crisis, sooner or later**. Exchange-listed companies – in particular credit institutions - lost market capitalisation as the crisis spread from its origins to wider sectors. Exchanges' share prices have also recently tumbled in line with the financial companies.

In fact, the exchanges have continued to provide **liquidity** to the markets, despite the difficult circumstances and the freeze in many segments of the financial sector.

In addition, exchanges all over the world have responded to the new challenging environment, for instance by launching **CCP clearing mechanisms** for OTC traded products.

What lessons has the exchange community drawn from the crisis?

The most important one is that the **structure of a market** is extremely critical to its long-term sustainability and the risks it poses for the rest of the sector and the world economy. Moreover, **liquidity** requires **transparent and reliable price-formation mechanisms**. The crisis has reminded market participants of the intrinsic positive qualities of trading in regulated and transparent market environments. And since FESE members represent the **most transparent public market structure in Europe**, we began to realise that we should take more pride in our model.

To see how important this is, just remember that only a few years ago, the European Regulated Market model had seemed almost "out of fashion". At the height of the last economic cycle, there was some scepticism towards the model of public markets – 'private' seemed superior to 'public' whether one looked at issuance, trading, or reporting.

Well, today, after the devastating events of the last 12 months, **the time has come to look more closely at the risks posed by different market structures.** Yes, the economy needs all sorts of market structures, for all sorts of users, but we need to regulate these markets properly and according to a functional approach. We need to manage the different risks they pose.

Otherwise, short-term gains and profits for one business activity may lead to disastrous long-term losses for the rest of the economy and for citizens.

As the operators of the public market model in Europe, FESE members believe that we have something positive to contribute to this debate**.** First of all, we can help with initiatives such as OTC clearing. And we can also put our expertise from the public market model to the service of **improving market transparency and reducing risk in other market structures and models.**

And what is this expertise? Our markets aim to offer transparent price discovery and liquidity for assets admitted to trading. **Exchanges worldwide** put into practice a number of **important principles:**

- We are **transparent.** Prices are set with all the possible information available through real-time dissemination tools.
- We are **multilateral.** Prices are discovered through the aggregation of the expectations of many investors through their bids and offers, which ensures reliability, a high degree of information as well as liquidity under the most demanding market conditions.
- We are **neutral and independent**. We endeavour to ensure an equal treatment for all our participants as well as to provide the set of rules and the IT infrastructure that best serve the interest of all investors – retail and institutional.

Over time we have de-mutualised, we moved from floor trading to electronic orderbooks, most of us even listed. We continuously adapt to the changing landscape, the revolutions in technology and the needs of our clients. However, we have **never** sacrificed our principles!

Based on what we know from our markets, we believe that EU policy in the securities field must be re-oriented. It should follow **five guiding principles:**

- First, a shift towards a set of new objectives, above all interest of **investors, market integrity** and **systemic stability**.
- Then, encouragement for companies to tap investors through **public markets** that offer higher levels of pre- and post-trading **transparency**, and **neutrality**
- **Removal of all disincentives** that suppress access to public markets.
- **Another important principle: Enforcement** of existing protection for both retail and professional investors, such as information and disclosure requirements,

suitability and appropriateness tests and best execution, **with vigour and consistency** across the EU.

- Also important: Designing **any further liberalisation of markets**, whether within the EU or between the EU and 3rd countries, in a way that safeguards the interests of investors and generates new business opportunities, without giving undue advantages to incumbents.
- And finally, strengthening **the supervisory system in Europe to address the future challenges effectively.**

These are all areas in which an association such as FESE has much to contribute and areas in which we believe the next European Commission and Parliament will have to work on. In fact, we will all have to work towards these goals together, not only in our own jurisdictions, but across the world.

Now, remember I said that FESE members do not see themselves as an island on to themselves. The same is also true in the way we see European regulation in a global context. This is why we strongly believe in **global regulatory and supervisory cooperation.**

Long before the crisis, European exchanges have known that their business is **global.** The last two years of international consolidation within the exchange industry has been remarkable. At the same time, we see increasing competition between Asia, Europe and North America to attract new listings. There is an increasing push for further integration of capital markets – which calls for more coordination among regulators and supervisors.

Today, we need this cooperation more than ever in order to <u>recover investor confidence</u>.

FESE has **two main global priorities**:

- First, to contribute to IOSCO's and other regulators' work towards better global standards.

- Second, to work with regulators who are interested in mutual recognition projects, to open up their markets to greater competition.

I am happy to say that, **at the global scene, FESE's main and preferred industry partner is the WFE.** The WFE has an incredibly important role to play in this new world in which global cooperation is critical to getting results. That is why I am pleased with the recent new initiatives we have taken together to diversify and deepen our common activities: we already cooperate in data methodology, but we are also now working together on regulatory issues.

As the President of FESE, I intend to work closely with both the industry and the regulators from other regions of the world to achieve our common objective of <u>safe and orderly markets.</u> Europe's exchanges will continue to act globally and work towards markets that inspire investor confidence.

Thank you for your attention.