Introduction

The governance of infrastructure institutions in the financial markets has become a matter of significant commercial, regulatory, legislative, and even political concern. These institutions include exchanges (such as Istanbul Stock Exchange, NYSE Euronext, and Stock Exchange of Thailand), central counterparties (CCPs) (such as EuroCCP, Japan Securities Clearing Corporation, and LCH.Clearnet in the UK), and central securities depositories (CSDs) (such as The Canadian Depository for Securities, Indeval in Mexico, and Strate in South Africa). They play a fundamental role in ensuring the efficiency, safety, and soundness of financial markets globally, and more generally in furthering economic development. The manner in which market infrastructure institutions are governed critically affects their performance. There is great debate, however, both about how they are governed and about how they should be governed.

Nature of Governance

Governance is about power, and three questions are critical in understanding the governance of market infrastructure institutions: Who has what power at such institutions? How and why do they obtain it? and, How and why do they exercise it? Answers to these questions for any particular market infrastructure institution are determined in large part by the formal, legal, and regulatory constructs within which it operates. These include the institution's constitution and associated corporate governance attributes, namely its corporate status and mandate, its ownership structure, the composition and role of its board, the role of its management, the rights of its shareholders and other stakeholders, and the relationships between board, management, owners, and other stakeholders. Other legal and regulatory factors also influence the exercise of power at a market infrastructure institution, including key contractual arrangements, its regulatory status, and any regulatory powers or duties it is allocated. In addition, a range of informal, nonconstitutional, and noncontractual factors may affect an institution's governance, such as the historical, cultural, and political framework within which it operates.

Concerns

There are many reasons why the governance of financial market infrastructure institutions is now seen as critically important. The financial crisis that began in 2007, as with past such crises, has led to public and political interest in the workings of financial markets, and in particular in the infrastructure institutions that seek to guarantee their safe operation and protect investors. Extreme volatility in the markets has both increased worries that the market infrastructure institutions central to the operation of financial systems may fail, and also increased pressures for trading, clearing, and settlement to be centralized on precisely such institutions. Notwithstanding the current high level of anxiety about market infrastructure institutions as a result of the present financial crisis, at some stage this apprehension may diminish as the severity of the crisis recedes. Concern about market infrastructure governance will, however, remain for many other reasons.

There is controversy about what is the most efficient way of governing market infrastructure institutions. Market practitioners now realize that the manner in which these institutions are governed may affect both the fees they pay and more generally the viability of their business models. There are also concerns about whether the pursuit of private interests at market infrastructure institutions is leading to anticompetitive behavior, and conversely about whether the pursuit of public interests at such institutions is adversely affecting efficiency.

There is mounting anxiety about the presence of conflicts of interests at market infrastructure institutions, and about whether governance mechanisms should be put in place to minimize the occurrence of such conflicts, or to facilitate the management of them when they do arise. Concern about conflicts of interest has become particularly acute where market infrastructure institutions have been allocated regulatory powers or duties.

The global focus on corporate governance, following various major corporate scandals, and the development of various international codes on corporate governance, such as from the Organisation for Economic Co-operation and Development (OECD), has brought to the fore questions concerning the governance of market infrastructure institutions. A range of mechanisms have been proposed globally with the prime aim of protecting shareholder interests, such as the adoption of independent directors on corporate boards. Whether these mechanisms are appropriate for market infrastructure institutions has, however, been controversial.

Consolidation among market infrastructures at both a national level (such as the creation of SGX in Singapore) and at an international level (such as the merger between the NASDAQ and OMX), and the perceived growing market power of such institutions, has led to disagreement about whether there should be greater regulatory, legislative, and even political intervention in their governance. This debate has been complicated by differences of opinion about regulatory goals, and also by the pursuit of national interests by various jurisdictions.

Not only has no global consensus developed for the optimal way of governing market infrastructure institutions, no framework for deciding what governance model is appropriate in different circumstances has been developed either. Very distinct governance models are currently being implemented across the globe and across different types of market infrastructure institutions, with demutualization, user governance, and public ownership and control, for example, all being actively promoted.

Issues

This book analyses the two fundamental issues of how market infrastructure institutions are governed, and how they should be governed. In order to assess how market infrastructure institutions *are* governed, four broad topics are examined:

- The key types of governance models market infrastructure institutions adopt
- The manner in which market infrastructure institutions are governed in practice;
- The way in which regulatory powers are allocated to market infrastructure institutions;
- The way in which market infrastructure institutions' governance is regulated.

In order to evaluate how market infrastructure institutions *should* be governed, three central policy questions are evaluated and answered:

- What is the most efficient form of governance for market infrastructure institutions?
- What regulatory powers, if any, should be allocated to market infrastructure institutions?
- What regulatory intervention in the governance of market infrastructure institutions, if any, is desirable?

Approach

A central thesis presented here is that there is no single global answer either to the question of how market infrastructure institutions are governed, or to the question of how market infrastructure institutions should be governed. Instead, the answers to these questions are specific to the contexts in which they are raised. This argument contradicts the notion promoted in many other analyses of financial markets, that standardization, harmonization, and the creation of an international consensus are critical. A key aim of the book is to provide insight into the governance of market infrastructure institutions for a wide range of situations globally. Much of the analysis is therefore presented in an abstract and general way so as to be useful across different types of institutions, jurisdictions, and contexts. Rather than offering any specific recommendations to address the key policy questions examined here, a series of general propositions are articulated in order both to capture the wide range of arguments discussed here in a simple and accessible manner, and to encapsulate the main lessons of the analysis. The book does not present answers to how market infrastructure institutions should be governed in any particular jurisdiction or context, nor does it provide simple or single conclusions.

In order to understand the complexity inherent in the topic of the governance of market infrastructure institutions, different types of analyses are necessary. In particular, it is vital to assess a broad range of both conceptual and specific issues, and also to appreciate that the two types of issues are inextricably linked. Although answers to conceptual questions concerning governance frequently transcend national, temporal, and physical, boundaries, no understanding of the conceptual is possible without a foundation of knowledge and information about specific instances and contexts to which the abstract is applicable. Conversely, a conceptual framework is required in order to describe and categorize any specific context under consideration. In seeking to understand the governance of market infrastructure institutions, it is also essential to draw on the knowledge and experience available from a wide spectrum of academic and practical fields, including business, economics, finance, law, regulation, and politics. Three broad methodologies are used in the book. Some analytical exegesis is employed to examine various conceptual issues, a range of survey evidence is presented to describe key aspects of how market infrastructure institutions are governed and regulated globally, and various case studies detail the particularities of specific situations and decisions at different market infrastructure institutions.

Structure

The book is composed of 10 main chapters in addition to the introduction, grouped into four parts. Part I contains two chapters that provide key background information and analyses necessary for an understanding of how market infrastructure institutions are, and should be, governed. Chapter 1 provides some insights into the definitions and nature of an "infrastructure," an "exchange," a "CCP," and a "CSD," and explores the reasons why these concepts are sometimes ambiguous and controversial. Chapter 2 analyses a key determinant of whether exchanges, CCPs, and CSDs should be considered infrastructure institutions, namely whether they have market power.

Part II contains three chapters that survey different aspects of how market infrastructure institutions were governed and regulated throughout the world as of the end of 2006. Chapter 3 compares how different jurisdictions allocated regulatory powers over their securities markets. Three surveys on the topic, covering various jurisdictions and institutions, are described and evaluated. Chapter 4 examines a unique set of assessments of securities markets and of their regulation from countries around the world, undertaken jointly by the International Monetary Fund (IMF) and the World Bank, in order to provide a global perspective on policymakers' viewpoints about the regulation and governance of market infrastructure institutions. Chapter 5 provides an overview of how market infrastructure institutions around the world were governed in the cash equities markets.

Part III contains two chapters that present a series of case studies illustrating how some particular market infrastructure institutions have been governed in practice in specific contexts. Chapter 6 presents case studies for various exchanges, and chapter 7 does the same for various CCPs and CSDs. A few brief general lessons from each case study are also identified.

Part IV contains three chapters that analyze, and make recommendations about, how market infrastructure institutions should be governed, and how their governance should be regulated. Chapter 8 analyzes the optimal governance model for market infrastructure institutions using the broad goal of efficiency as the main yardstick to compare different models. Three fundamental elements of governance are examined: ownership structure, mandate, and board composition. Chapter 9 discusses what regulatory authority over securities markets, if any, should be assigned to exchanges, CCPs, and CSDs. The question is analyzed in the broader context of examining how regulatory powers should be allocated between government regulators, self-regulatory organizations (SROs), and other types of regulatory institutions. Chapter 10 explores what regulatory intervention in the governance of market infrastructure institutions, if any, is optimal. Attention is focused on how such intervention can enhance the realization of three core objectives of securities markets regulation: the protection of investors; ensuring that markets are fair, efficient, and transparent; and the reduction of systemic risk.