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FESE Response to European Commission Consultation Paper on Possible Recovery and Resolution Framework for Financial Institutes other than Banks

1. Introduction

The Federation of European Securities Exchanges (FESE) represents 46 exchanges active in equities, bonds, derivatives and commodities through 21 full members from 30 countries, as well as 7 observer members from European emerging markets. FESE is a keen defender of cross-border competition and many of its members have become multi-jurisdictional exchanges, providing market access across multiple investor communities. FESE members operate Regulated Markets (RMs), which provide both institutional and retail investors with transparent and neutral price-formation.

FESE members are glad to have the opportunity to contribute to this consultation. FESE supports efficient, fair, orderly and transparent financial markets that meet the needs of well protected and informed investors and provide a source for companies where to raise capital and for investors to hedge their portfolios.

Below you will find our response to the questions in the consultation which relate to regulated markets.

2. Response to the Consultation Paper

Section 5.2 - Other non-bank financial institutions

This section of the consultation deals with other non-bank financial institutions that could, under certain circumstances, contribute to the build-up or transmission of risks that may, should they fail, have systemic consequences. The consultation suggests as examples investment funds and trading venues of various kinds.

In the following paragraphs we answer the two questions in the consultation related to regulated markets.

Our responses below describe how trading venues, and regulated markets in particular, are financial institutions who do not assume risk associated with the products traded as they are never trading in their own right and whose failure would **not** necessarily cause systemic consequences. Regulated Markets are entities that differ from banks, insurance companies or other financial institutions, in many respects, as a result of which they do not need to be subjected to a framework for recovery and resolution.

Questions included in section 5.2 of the consultation

2. Besides those covered in previous sections of this paper, which other nonbank financial institutions can become systemically relevant and how? Depending on the type of institutions, what are the main channels through which such systemic risks are transmitted or amplified?

General

Contrary to the position of banks, insurance companies or other financial institutions which trade or maintain positions or monies on behalf of investors or themselves, we believe that the unlikely case of a failure of a regulated market would not pose a risk to financial stability. This is mainly because regulated markets are not institutions whose main purpose is to assume risk in one way or another. Regulated markets purely serve as means to allow investors to interact and enter into transactions in an orderly, transparent and supervised manner. The risk assumed by this interaction is never assumed by the regulated market, as it is transferred from one market participant to another market participant, usually via a central counterparty (CCP).

A sudden failure of a regulated market would not necessarily leave any client in major distress. Below we explain the impact of a potential failure of a regulated market first in general and then by different asset classes.

How would equity and bond markets be affected by a failure of a regulated market?
The amount of time that the trading venue is involved in facilitation of a transaction is generally minuscule (microseconds). Trades may occasionally be affected by technical glitches, but these do not necessitate a market resolution regime. These are dealt with through different means by regulated markets each specific to the underlying circumstances prevailing at the time. Regulated markets are usually equipped with back-up systems to which trading could be diverted in the case of such an unlikely event. In addition, in the completely unlikely case of a total disruption of trading venues the market has the means to divert activity if the period of outage is substantial. In this unlikely scenario, issuers listed on that market would be required to transfer their shares to a different regulated market in another country.

Evidence confirms that equity markets have only been affected by a small number of technical glitches of negligible severity during the last decade. No European regulated market has had to suddenly close. Problems related to technical glitches have already been the subject of intense regulatory scrutiny and are being addressed through a series of separate measures. These are operational issues, not systemic, and as such do not necessitate resolution and recovery frameworks. As stated above, even in the case of a major catastrophic scenario related to regulated markets, this would not necessarily lead to a systemic issue, as regulated markets are purely facilitators of the market place rather than participants in risk accumulation.

How would derivatives markets be affected by a failure of a regulated market?
As stated above, regulated markets purely serve as means to facilitate transactions between market participants. They do not concentrate or manage risk like other risk-taking market actors do. The activities of the regulated markets members are risk-managed by the relevant CCPs who assesses the level of risk undertaken and ensures sufficient measures are taken to mitigate this risk such as default fund contributions, margin and ensures appropriate collateral is in place.

The short term disruption of a trading venue would have no systemic effect on market operation and trading members will evolve measures to ensure that there is a solution available to investors

3. In your view, what could be meaningful thresholds in relation to the factors of size, interconnectedness, leverage, economic importance or any other factor to determine the critical relevance of any other nonbank financial institution?

Under our response to question 2, we made it clear that we do not think regulated markets should be subject to the resolution and recovery framework. Consistent with this view, we explain below why these activities do not raise systemic concerns from the point of view of the factors included in this question and those suggested in the consultation:

- Size: Regulated markets are relatively small companies compared to other financial institutions. As stated above, regulated markets are not risk takers but facilitators of orderly markets and size is not necessary a relevant indicator of risk to our business.
- Interconnectedness: Given the fragmentation now present in the markets, there is adequate potential for trading venues to offer services if a single venue encountered issues. However, unlike the actors in the banking space the execution venues are largely un-connected.
- Inherent economic importance: Each listing venue has an economic importance to its domestic market to facilitate efficient funding for enterprises and to facilitate the operation of secondary market activity.
- Degree to which regulated markets' businesses are exposed to leverage or pro-cyclicality: This factor is not necessarily relevant to the business of regulated markets other than by the fact that pro-cyclicality or a downturn in trading activity does have an effect on revenues for execution venues. However this does not seem to be a factor to declare regulated markets as systemically relevant.
- Degree to which regulated markets' businesses perform maturity or liquidity transformation: This factor is not relevant to the activity of regulated markets**.**
- Degree to which business would suffer from a lack of transparency regarding underlying exposures: Transparency has always been one the pillars of the activity of regulated markets. As a result of the

financial crisis, regulated markets have worked with regulators to promote the transparent business model of European regulated venues in the less transparent parts of the market that were at the origin of the financial crisis.

4. Do you think that recovery and resolution tools and powers other than existing insolvency rules should be introduced also for other nonbank financial institutions?

FESE members believe that due to its non-risk-taking nature, regulated markets should not be subject recovery and resolution tools and powers other than existing insolvency rules. As described above, contrary to other nonbank financial institutions, regulated markets do not assume risk associated with the products traded as they are never trading in their own right and whose failure would **not** necessarily cause systemic consequences.

5. In your view, what could then be meaningful points of failure at which different types of other nonbank financial institution could be considered to fulfil the conditions for triggering:
a) The activation of any pre-determined recovery measures; or
b) Intervention by authorities to resolve the entity?

Regulators can already take action against or close exchanges if they do not comply with our license conditions. While any commercial enterprise is, to some extent, exposed to the risk of insolvency, such a scenario is highly unlikely in the case of regulated markets as they are under permanent supervision of market authorities. Considering that the business-model of regulated markets is mainly based on the income derived from trading, the risk of insolvency rises with the level of market fragmentation.

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