DEUTSCHE BÖRSE GROUP

Deutsche Börse Group

Response

CESR Call for Evidence
Mutual Recognition with non-EU Jurisdictions, June 2009

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I. Introduction

Deutsche Börse AG ("Deutsche Börse" or "DBAG") appreciates this opportunity to provide evidence on mutual recognition as called for by the Committee of European Securities Regulators ("CESR"). As we have expressed in previous consultations on this topic, DBAG strongly encourages efforts by the European Union to improve market access to non-EU countries especially, but not exclusively, the United States. The recent crisis in the financial markets has highlighted the fact that financial markets are already tightly connected. Mutual recognition is one means to assure that capital flows are not impeded by barriers that do not serve appropriately to protect investors or facilitate efficient capital formation. Furthermore, DBAG believes that, against the background of crisis and recovery, now is an appropriate time for the world's regulators to recognize the stability that characterizes exchange trading of equities and derivatives and support mutual recognition as a means to international regulatory coordination.

Along with similar international initiatives to facilitate cross-border capital flows while achieving high regulatory standards, mutual recognition in the context of globalized securities and derivatives markets has the goals of assuring efficient access for investors to appropriate investment and trading instruments, cross-border access for issuers to sources of capital, competition among marketplaces and intermediaries, regulatory and legal certainty for cross-border transactions, and enhanced transparency among other benefits. As noted in CESR's "Call for evidence on mutual recognition with non-EU jurisdictions" mutual recognition *per se* is only one of several ways to address cross-border access. We respectfully ask that CESR consider our comments in support of any of the initiatives discussed in the call for evidence that would advance these same goals, not just as support for mutual recognition.

Deutsche Börse is a publicly listed financial services provider headquartered in Frankfurt, Germany. As one of the largest exchange organizations worldwide, it affords companies and investors access to global capital markets. Deutsche Börse and its subsidiaries also provide technology services, securities settlement services and market data products to customers worldwide.

Deutsche Börse operates the Frankfurt Stock Exchange (FSE), whose electronic trading platform Xetra® is directly accessed by 250 members located in 19 different countries. Among the largest stock exchanges in Europe, FSE is trading approximately 11,000 listed common stocks, around 370,000 structured products, 481 exchange traded funds, 136 exchange traded commodities, approximately 2,800 mutual funds and 24,000 bonds and is fully compliant with the Markets in Financial Instruments Directive.

Deutsche Börse indirectly owns 50% of Eurex Frankfurt AG which operates Eurex Deutschland (together "Eurex"), which is the largest derivatives exchange in the world for euro-denominated products.[1] Eurex has more than 400 member firms located in 23 countries, seven of which are outside the European Union (Australia, Croatia, Hong Kong, Singapore, Switzerland, United

[1] Deutsche Börse and SIX Swiss Exchange equally and jointly own Eurex Zurich AG which fully owns Eurex Frankfurt AG. Eurex Frankfurt AG owns 100% of U.S. Exchange Holdings, Inc., Eurex Clearing AG, and Eurex Repo as well as 79% of Eurex Bonds.

Arab Emirates and United States of America). Eurex is the centre of trading for all types of derivative products on European interest rates, equities and equity indexes.

We are pleased to provide the information below in response to questions raised in the Call which are relevant to our trading exchanges, FSE and Eurex.

II. Responses to questions for trading venues

Q5 Would the liberalisation of access to securities exchanges (through placement of trading screens) be of relevance to your business? Please provide any evidence/data/market statistic to support your view.

Liberalisation of access to securities exchanges has been vitally important for FSE and Eurex. Both FSE's Xetra® and Eurex operate independently of a member's location, permitting international participation. As such, they have been able to place trading screens with members throughout the EU including 18 EU countries outside of Germany for Xetra® and 15 EU countries outside of Germany for Eurex. The access to financial centres across the EU which these exchanges have enjoyed for years led to them to become the most important global markets for German equity securities and euro-denominated derivatives in the world.

Despite these high levels of international participation, Deutsche Börse's activities in the US, as in many other markets, have remained circumscribed due to current law and regulations. Furthermore, potentially valuable efforts last year to reform and improve foreign broker's access to US investors for purposes of soliciting transactions in foreign securities by revising SEC Rule 15a-6 seem to have been suspended.

FSE: US broker-dealers and institutional investors have signalled to FSE representatives a strong interest in obtaining direct access to the Xetra® trading system. Current US regulation seems to prohibit FSE from marketing equities trading in the US, providing investors with information about regulatory and business conditions on the FSE, connecting market participants to Xetra®, from locations in the US, and admitting US resident entities as members for trading on the FSE.

Eurex: Beginning in 1996, Eurex's predecessor, the DTB, was the first foreign board of trade ("FBOT") whose members were able to access the exchange's trading platform through computer terminals in the US., and accordingly its US members have been able to access the Eurex trading platform from trading terminals in the US for over thirteen years with respect to a wide array of broad-based equity index and fixed income futures and options on futures contracts under the provisions and conditions set forth by the US Commodity Futures Trading Commission ("CFTC") relief.

US investors have also expressed interest in broadened access to Eurex. However, although US members are able to access the Eurex market directly for trading futures, due to current US regulation, Eurex is not permitted to provide any terminal access to US resident members for its equity or equity index options.

The result of this disharmony is well illustrated through the example of Eurex's Dow Jones EURO STOXX® 50 Index products. Eurex members operating from locations in the US contribute about 17% of the volume in the Dow Jones EURO STOXX® 50 Index **futures** contract, which had an average trading volume of just over 1.7 million contracts per day in 2008. In contrast, the Dow Jones EURO STOXX® 50 Index **options** contract, which had an average daily volume in 2008 of about 1.6 million contracts, is not tradable from Eurex terminals in the US (nor is Eurex permitted to provide information about them to the US public except for eligible qualified institutional buyers (QIBs) and broker-dealers). This means that Eurex member firms, instead of trading directly and most efficiently, are forced to trade these option products through non-US affiliates or through operations set up outside of the US.

Q6 What are currently the main regulatory obstacles that prevent EU exchanges from setting up trading screens in third countries (differentiate according to countries). Can these obstacles in the current regulatory environment be overcome (via cooperation arrangements with third country markets, etc)?

Eurex and FSE face a myriad of barriers to doing business in non-EU jurisdictions. The two key restrictions are limitations on conducting exchange business without a full local exchange registration and marketing financial instruments that have not been registered with the local authorities. Very few jurisdictions outside of the EU have formal mechanisms for registering and supervising foreign exchanges. Even the CFTC, which has been one of the most progressive and flexible regulators in this area, operates under a relatively informal policy of granting *ad hoc* permissions to foreign exchanges.[2]

As described above, FSE and Eurex have set up trading screens with members located in multiple countries outside the EU. Both exchanges, however, have continued to face limitations around the world but especially in the US. Besides actively promoting mutual recognition initiatives, both exchanges have requested exemptive relief from the SEC that would allow FSE and Eurex to operate on a limited basis in the US without registering as a national securities exchange.[3] The purpose of the requested relief is to permit broker-dealers registered with and supervised by the SEC to become members of FSE and Eurex, to connect directly to FSE's and Eurex's electronic trading systems, and to allow FSE and Eurex to solicit business from and trade on behalf of a narrow class of qualified investors.

DBAG believes that, in establishing exemptive relief, mutual recognition, or substituted compliance regimes, regulators can be guided by current structures and organizations that are already in place. For example, regulatory cooperation and enforcement Memoranda of Understanding that have been concluded among foreign regulators not only can inform regulators about how workable present agreements have proven to be but also provide a sound guide to identifying those jurisdictions that are most willing and capable to cooperate satisfactorily with

[2] Eurex operates in the US in accordance with several "no-action" letters from the CFTC whereby the CFTC staff formally state that they will not recommend to the CFTC Commissioners that enforcement action be taken against Eurex provided that Eurex operates within business confines that it previously has represented to the CFTC staff.

[3] Letters to Elizabeth Murphy from Andreas Preuß and Michael Peters (Eurex) and Frank Gerstenschläger and Rainer Riess (FSE), dated August 5, 2009.

one another. A program built initially on acceptable agreements would provide investors access to a numerous and diverse set of foreign marketplaces within a short timeframe.

To the extent deemed necessary, determinations about the comparability of regulation in a foreign jurisdiction can be based on objective information. Regulators can evaluate their foreign counterparts' authority to enforce their own rules under local law. Critical might also be the regulator's authority to share certain non-public information and information gathered in the course of an official investigation with other regulators. Finally, regulators can assess the official requirements for issuers of publicly tradable securities, the nature of oversight and authority the foreign regulator exercises over brokers, and its licensing requirements for exchanges, clearinghouses, brokers and dealers.

Another helpful criteria regulators might consider relying on in evaluations of foreign exchanges would be minimum trading volumes. Significant trading volume indicates among other things that an exchange attracts and sustains investor and trader interest which in turn validates that exchange's effectiveness as a market operator.

Regulators might also want to consider the scope of any such exemptive relief, mutual recognition, or substituted compliance regimes. Some classes of investors, e.g. institutional investors and their brokers, are already active internationally but they would benefit from the downward pressures on costs and the upward pressures on service levels brought about by increased competition. We recommend, however, that any recognition framework even at first includes investors beyond them in order to have a demonstrable effect on trading patterns. Additional investors, for example those defined in the US as accredited investors,[4] might appropriately be the immediate targets of improved access to foreign securities.

Ideally, exchanges would be permitted to market their full ranges of investment securities and risk management products under any such exemptive relief, mutual recognition, or substituted compliance regimes. In Deutsche Börse's case, this would extend to all securities products that are listed for trading on FSE and Eurex including exchange-traded structured products. We understand, however, that regulators may think it prudent to adopt an incremental approach. In this case, in a first phase, access might initially be granted to all of the component stocks of the major foreign stock indexes, options on those component stocks, and futures, options and ETFs on the major foreign stock indexes that are traded on a recognized foreign exchange. The importance of the indexes themselves is indicated by the volumes of trading in derivatives based on them. For these purposes, an index on which derivatives trade in total volume of 25,000 contracts per day or more should be considered major. Once enough experience has been obtained with these initial instruments, regulators might consider permitting foreign exchanges to offer all tradable instruments to investors. Regulators could prioritize those instruments which are most liquid and actively traded for step-wise addition in any incremental approach.

Of course, regulators could choose to maintain the ability to modify or limit access to a foreign exchange's products if deemed necessary to protect the public interest.

[4] Defined in Regulation 501(a) under the Securities Act of 1933 as natural persons and institutions qualified to invest in hedge funds as these are assumed by the SEC to both be sophisticated and have adequate access to expert services.

Q7 Which third countries do you consider to be the most interesting to arrange a mutual recognition on stock exchanges (given your current or future business focus)? Which economic advantages and drawbacks do you foresee?

As described above, Deutsche Börse has gained experience in several markets outside of the EU, but access to US markets remains limited. Therefore, the focus of our response has been on the US market, although Deutsche Börse certainly faces restrictions in other regions, like Asia. In addition, the focus of our comments is not limited to stock exchanges but also to derivatives exchanges.

The US is not only the largest trading and investing market outside of the EU, but it also has functioned, along with the EU, as an international leader in regulatory development.

Q8 What would you consider to be the effects on the market as a whole, in terms of liquidity and integrity, of:
a) foreign stock exchanges locating trading screens in EU Member States?
b) EU stock exchanges locating trading screens in third countries?

Deutsche Börse believes that enhanced investor access to exchanges located worldwide will bring significant benefits to the market.

Some form of exemptive relief, mutual recognition or substituted compliance would enhance transparency and investor protection in international securities and derivatives trading by permitting cross-border trading to be conducted by registered broker-dealers in the most efficient manner. Furthermore, it would recognize the increasing internationalization of securities and derivatives markets and would promote global dialogue on appropriate and efficient market regulation will benefit all entities.

Today, broker-dealers and qualified investors in many jurisdictions, for example in the US, seeking to trade products on foreign exchanges must access those exchanges through a member located outside the US. This arrangement can be established through affiliates of US broker-dealers or through arrangements US broker-dealers have with an exchange member off-shore. Execution of orders on those exchanges for broker-dealers and US investors thus requires at least one layer of intermediation by a foreign broker or dealer in the trading process or requires investors to incorporate subsidiaries overseas that become an exchange member to gain direct access. Such business strategies result in higher costs with lower execution efficiency for the investor and result in transactions that occur outside of the direct oversight of the regulator. The prohibition on electronically trading these instruments in the US also acts to encourage market participants to trade in the less transparent over-the-counter markets. None of these outcomes is in the public interest.

Exemptive relief, mutual recognition, or substituted compliance regimes would therefore lead to benefits for US investors by enabling them to have more direct and efficient access to the markets that they target for their investments. Investors would enjoy lower costs, more transparency, and heightened competition for their order flow and more timely corporate information. In addition, with better access to foreign derivatives exchanges, US investors would be able to more easily hedge their foreign equity transactions and manage the risks of holding portfolios of foreign securities.

Q9 What are the main factors, if any, making "remote membership" different from direct electronic access? To what extent are such differences affected by:
a) amount of fees paid;
b) post-trading services;

Deutsche Börse believes that there is no need to distinguish among members based on their location. At both FSE and Eurex no distinction is made between members located in Germany or outside Germany, whether within the EU or elsewhere. All members are held to the same high standards of integrity, supervision, rules, and regulations. For example, members who conduct customer business must, among other things, be registered to do customer business in their home jurisdictions.

Q10 What are in your view the main competitive risks posed by:
a) foreign stock exchanges locating trading screens in EU member states?
b) EU stock exchanges locating trading screens in third countries?

Deutsche Börse believes that enhanced investor access to worldwide exchanges will improve competition to the benefit of investors. However, it is also cognizant of the potential risks posed by foreign exchanges that do not meet EU standards and the challenges this will pose to policymakers and regulators in the formation of an access framework as well as the ongoing monitoring process. For example, it is not clear to what extent foreign exchanges might meet or be required to meet the standards of practice, for example as regards price transparency, codified in the Markets in Financial Instruments Directive.

III. Conclusion

Deutsche Börse Group welcomes the call for evidence and looks forward to future contributions as they may be requested. We hope that these comments have been useful and remain available for further discussion. If you have any questions please do not hesitate to contact:

Michael Krogmann
Head of Section, Xetra® Market Development
Deutsche Börse AG
e-mail:
Michael.Krogmann@deutsche-boerse.com

Ingrid Vogel
Market Policy
Deutsche Börse AG
e-mail:
Ingrid.Vogel@deutsche-boerse.com