To Be Or Not To Be?

Demutualisation Survey

February 2001

bta consulting

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1 Executive Summary

1.1 Complexity and mindset

Many exchanges view demutualisation as the panacea for all their present woes without fully realising, or indeed understanding, the complexities that this encapsulates. Demutualisation involves a complete wholesale corporate culture transformation – changing every facet of an exchange. A successful demutualisation also involves a transformation in mindset. A commercial animal must abandon the yoke of the mutual or risk extinction.

1.2 Only 46% of demutualised exchanges are happy with the results

Despite the potential to create significant shareholder value the demutualisation opportunity is not being fully exploited. 100% of "happy exchanges" have pushed the demutualisation program towards Step 9 in the BTA Methodology (see Appendix 1). This means that these exchanges are listed, or the shares of the exchange are publicly tradable. By contrast, more than half of the 54% of exchanges that were unhappy stated that they had not gone beyond step 2, and had restricted their demutualisation program to a legal process that converted members into shareholders of a profit making entity. Such demutualised exchanges, are to all intents and purposes, still mutuals, and have failed to unlock the hidden value of the exchange. They still operate a consensus driven management approach and in some cases responding to interference from Government. It will be these exchanges that will soon lose out in the global competitive landscape.

1.3 79% of exchanges will demutualise within 2 years

The herd effect has certainly set in and 79% of exchanges are considering demutualisation in the next two years. This is good news for those stakeholders that will actually benefit – but timing is now of the essence. The global capital markets will be saturated with traditional exchange shares, which so far have been issued at prices that do not necessarily reflect earnings. The historic critical success factors of existing demutualised exchanges will be insufficient to realise future values and exchanges will need to go the extra mile. The additional critical success factors are contained within this report, including getting demutualisation right first time.

1.4 54% of exchanges have poor relationships with third parties

Demutualisation has not been without its costs. Demutualisation has not lead to improved relationships with regulators, members, or listed companies. This has been caused by a lack of the comprehensive stakeholder management program within demutualised exchanges and in the case of regulators; they have changed the ball game post demutualisation. Regulators fear demutualisation will lead to compromises in self-regulation through cutting corners to achieve profitability targets. The reality is that surveillance will be an integral part of the branding and competitive positioning of exchanges. It is unwise for exchanges with a modern corporate governance structure to compromise on surveillance standards in the pursuit of short-term profits. It would be advisable for IOSCO to determine a blueprint for demutualised exchanges covering both the SRO activities and the tariffing mechanisms.

IF YOU ARE ALREADY DEMUTALISED THE SURVEY EXPLORES IF THIS HAS MET YOUR EXPECTATIONS (PLEASE GO TO PAGE 24).

2 Introduction

The key buzzwords in the capital markets are flexibility and innovation, without these words in their "vocabulary" exchanges will become dinosaurs or be surpassed by new entrants such as electronic communications networks (ECN's). Two key drivers are forcing exchanges to change:

- Increasing pressure from the market for low cost cross-border access; and
- The advent of alternative trading platforms, such as ECN's driving market share away from the traditional exchanges.

These drivers are increasingly placing demands on traditional exchanges to become more commercial in their approach to the market. Many exchanges feel that the cosy world of the mutualised exchange does not provide the flexibility to adequately meet these new challenges. Hence demutualisation is seen as the panacea for their problems.

However, implementing a demutualisation program is not trivial. It represents a wholesale corporate cultural transformation – changing every dimension of an exchange. BTA has created a standard blueprint, which can be adopted for any demutualisation endeavour. This blueprint accommodates each exchanges own unique set of variables and challenges. Exchanges that simply view demutualisation as a legal manoeuvre are courting suicide. Why? Because the landscape for demutualised exchanges will be saturated within two years and the aggressive commercial and innovative demutualised exchanges will succeed. Accordingly there are whole ranges of issues that need to be analysed and considered before demutualisation commences:

- What does the exchange hope to achieve from demutualisation and how far is the management prepared to commit to achieving complete demutualisation?
- What infrastructure needs to be in place to achieve the desired results?
- What is the appropriate corporate governance structure for an exchange?
- How does the demutualised entity provide for stakeholder value and profitability?
- How do you unlock the hidden value within the organisation before an IPO takes place?
- How do you protect your brand in a post-demutualised environment?
- Can you achieve your business goals, and in particular your target earnings rates when regulators are setting moving targets?

These are just some of the many questions that need to be answered. A failure to recognise these issues risks damaging an exchange's reputation or worse still burdening it with problems for the future.

The term demutualisation hides a number of complex issues that need to be understood and addressed. The unique nature of exchanges also tends to cloud ongoing debates over the merits of demutualisation. Exchanges are seen as platforms for creating fair and efficient capital markets, with a duty to protect the public interest.

In mature markets, exchanges face competition and are typically not saddled with an exclusive public policy role. Accordingly their demutualisation program has a greater probability of success and facilitates a truly global business.

By contrast attempts to demutualise exchanges in emerging markets are complicated by nationalistic barriers, as well as the necessity to make them commercial, sometimes without the critical mass. The lack of adequate empirical data from wide-scale case studies makes the debate on demutualisation even more difficult.

Contrary to the opinion that there is an increasing trend towards demutualisation, not all mutual exchanges have decided to demutualise. There remains a school of thought that is not convinced of the merits of demutualisation. They argue that some of the most successful exchanges in the world are still thriving while mutualised. For example, the New York Stock Exchange is surely the most successful global exchange brand in the world. Even some demutualised exchanges believe that exchanges can succeed while keeping their mutual status.

Against this background, BTA Consulting decided to pioneer research into demutualisation. The response from exchanges around the world was overwhelming. *24% of exchanges participated. Over 80% of demutualised exchanges also took part in the survey, which we believe has allowed us to uniquely distil the key issues that encapsulate the demutualisation debate, and draw authoritative conclusions from the data collected. This represents in excess of 50% of the world's trading liquidity.*

The results reveal facts that contradict some of the commonly held beliefs surrounding demutualisation. This research is also complemented by our own experience of operating demutualised exchanges.

This research report explores the debate between whether an exchange should demutualise or remain a mutual entity:

- If demutualisation is the right way to move forward.
- Where demutualisation has been implemented, whether its been successful
- If demutualisation has been successful how has it been achieved?
- A look at the experiences of demutualised exchanges.
- And finally if the future will be representative of the past.

BTA would like to thank all the exchanges that participated in the survey and have contributed to furthering the debate on demutualisation.

3 Does Demutualisation guarantee future success?

"Being demutualised means that you have wider access to capital and greater flexibility to make decisions without the hindrances of being mutual"

Very few exchanges would disagree with the fact that the current competitive climate has never been so intense:

- ✓ The barriers to entry for new entrants have been slowly eroded through market pressures and increasing dissatisfaction with the way Exchanges have been managed.
- ✓ Stakeholders can be easily raided.
- ✓ New electronic alternative trading systems seem to be mushrooming.
- ✓ Fragmentation in an un-level playing field is rife.
- ✓ In response to systemic risk management via central counterparties, there will be changes in price discovery forums.

BUT does this really mean that the days of the mutual exchanges are numbered? This depends on the market…! National laws can act as barriers to competition and in effect create monopolies.

There are obvious advantages to demutualisation:

- ***Financial agility*** - Demutualised entities have wider access to capital and can have wider horizons compared with mutualised exchanges. This gives the demutualised exchange a competitive edge in winning business and a better position to embrace the technology evolution (although there is no evidence of this yet).
- ***Lack of "peer pressure"*** – The major weakness of a mutual exchange is its constitution. Mutual exchanges are ultimately geared maintaining their members interests. The interests of the members are not necessarily the same as those of the exchange; they are disparate. The separation of shareholders, management, and users in a demutualised exchange makes for better strategic decision-making, rather than protecting vested interests.

3.1 Are exchanges at a disadvantage by remaining mutualised?

"75% of the mutualised exchanges consider that doors are closed to them by virtue of being mutualised"

Although there is a school of thought that still believes the remaining mutualised will not undermine their competitiveness, the results of the survey show that 75% (see Figure 1) of the mutual exchanges that responded believe they are not free to pursue optimum commercial solutions for their exchange.

Furthermore, 58% said that mergers, acquisitions or alliances were unlikely to be an opportunity that could be easily pursued. Other recently published statistics also point to the same conclusion. For example, at a recent meeting of the Federation Internationale des Bourses (FIBV), 65% of the delegates agreed, "the merger of exchanges will lead to a system of a few very dominant players, thus marginalizing smaller markets." [1] In today's competitive environment any entity that is handicapped by its corporate structure will face difficulties in strategic decision making and is highly unlikely to prosper or survive in the long-term.

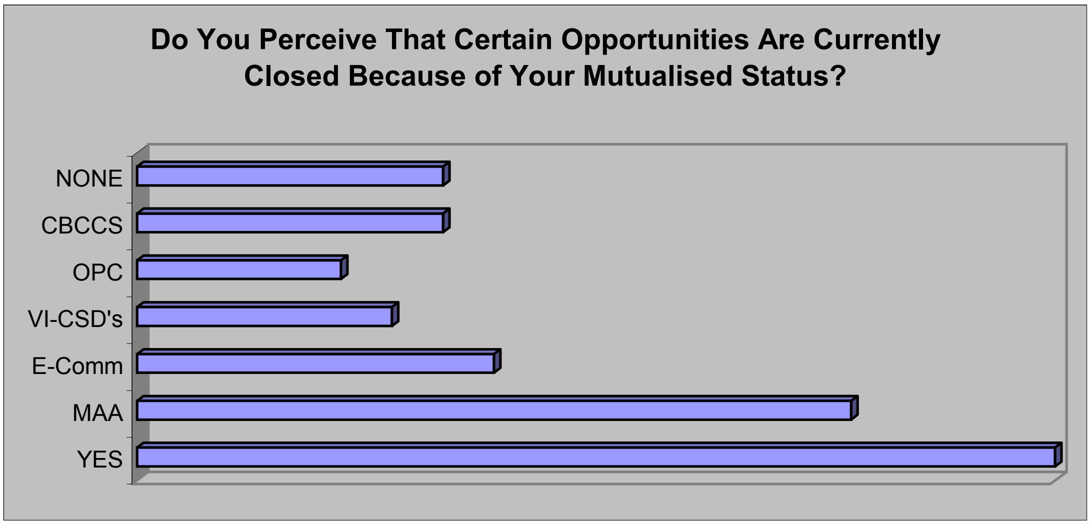

Figure 1: What opportunities are closed to Mutual Exchanges?

Note: The acronyms used in the figure above indicate some of the opportunities that have arisen for exchanges to create further value added services:

CBCCS = Cross border central counterparty services. OPC = Outsource back office service

VI-CSD's – Vertical integration with CSD's. E-Comm – E-commerce initiatives

MAA – Mergers, alliances and acquisitions

[1] FIBV Conference, 3 Oct, 2000, A snapshot of the exchange industry

3.2 The future is clear, the future is demutualisation

"64% of the demutualised exchanges and 60% of the mutualised exchanges believe future success is founded on being demutualised"

One of the far more surprising findings of the survey concerned the perception that the future direction of success exchanges can only be achieved by demutualising. Both demutualised (see Figure 2) and perhaps less expectedly mutualised exchanges (see Figure 3) were united in this opinion. Demutualisation is the way forward, but why? The remainder of this report elaborates on the reasons.

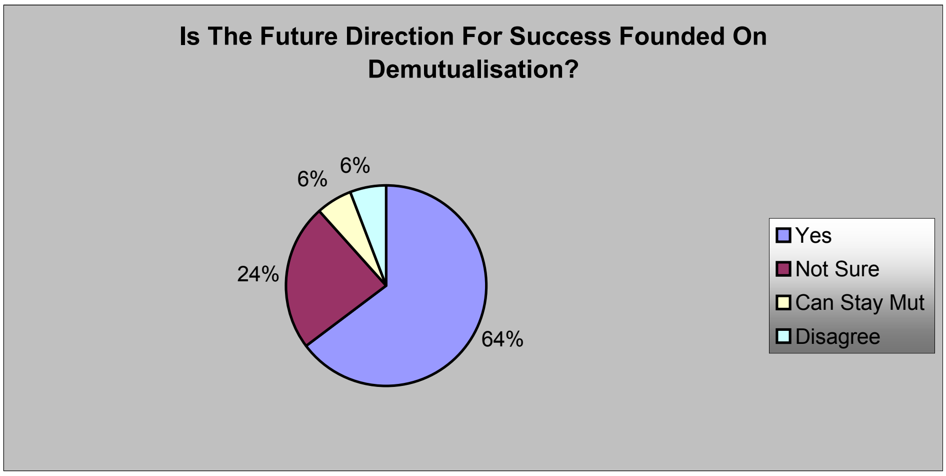

Figure 2: Demutualised exchanges – Is demutualisation key to success?

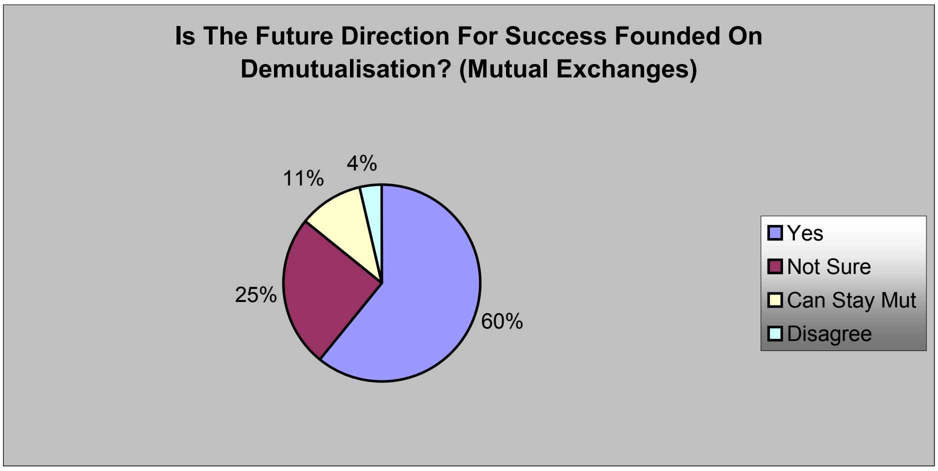

Figure 3: Mutualised exchanges - Is demutualisation key to success?

3.3 Is Demutualisation simply a conversion process?

"94% of Demutualised and 81% of the mutualised exchanges agree unanimously that demutualisation is not just becoming a for profit organisation"

Demutualisation can take many flavours and there are many paths that an exchange can travel to reach this goal. Most exchanges will have their own unique issues that may affect which corporate structure the exchange aspires too. However, both the demutualised (94% - see Figure 4) and mutualised (81% - see Figure 5) exchanges unanimously agreed that the end result of demutualisation is not simply becoming a for profit company, but there is a need to cultivate a complete wholesale cultural change within the organisation. This implies that demutualisation is not a legal project but a multidisciplinary programme lead by the Chief Executive Officer, Chief Financial Officer, and Chief Marketing Officer.

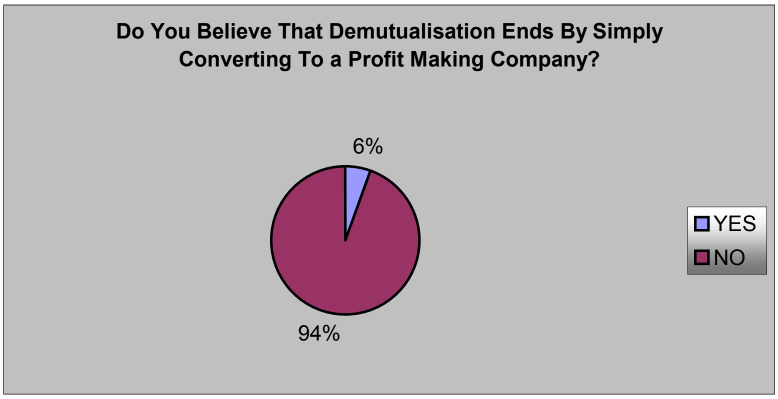

Figure 4: Demutualised Exchanges - is demutualisation simply a conversion exercise?

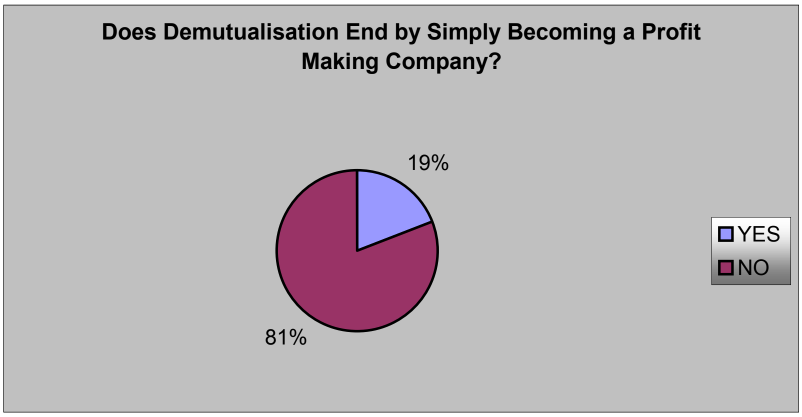

Figure 5: Mutualised Exchanges - is demutualisation simply a conversion exercise?

3.4 Is there a "herd instinct" mentality among mutualised exchanges?

"Only 21% of the mutualised exchanges are not thinking about demutualisation"

A recent discussion paper from IOSCO on demutualisation[2] shows that of the 52 exchanges present at the FIBV annual meeting 15 had demutualised, 14 had member approval to demutualise, and 15 were actively contemplating demutualisation.

This overwhelming result is confirmed by the results of our research (see Figure 6). Only 21% of mutual exchanges said that they were not going to demutualise or had no plans to do so in the foreseeable future. These were exclusively in closed emerging market economies.

It is important to evaluate whether exchanges have seriously considered the impact that demutualisation will have on their operations, market, and users or indeed planned how they are going to migrate and manage the business through the whole process or identified the key issues?

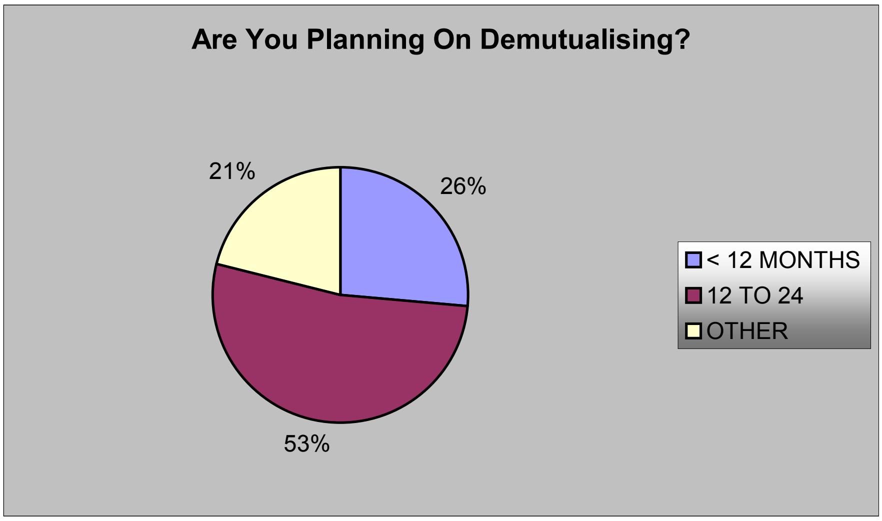

Figure 6:Mutualised Exchanges planning to demutualise

Note: Other = Exchanges who were either never going to demutualised or not for a least the next 5-10 years.

2 **Source**: IOSCO Discussion Paper on Stock Exchange Demutalisation, Dec 2000

4 A Demutualisation plan is not a trivial pursuit!

"Demutualisation requires a complete change management programme"

Implementing a total demutualisation programme is not trivial- it represents a wholesale corporate culture transformation- changing every dimension of an exchange. Yet the barriers to demutualisation are significant, mainly because the current modus operandi has been perpetuated for over a century. Most exchanges have yet to embrace demutualisation in its widest form and face being marginalized by more nimble new entrants and their customers. Strategically deciding to ignore demutualisation because it is too difficult is not an option, and would be a huge error of judgment - both financially and reputationally. The only real choice is to grab the bull by its horns and go through the demutualisation process. Like any well executed military operation, planning, timing, leadership (as opposed to hosting), teamwork, marketing, and courage are the important ingredients.

4.1 What's in a word? – Hidden pitfalls!

"There are many rivers to cross … 75% of the demutualised exchanges believe that creating the appropriate corporate structure is the most difficult"

The exchanges that have demutualised have not done so without crossing numerous hurdles. Unsurprisingly, the four areas of demutualisation (see Figure 7) that proved to be most problematic were:

- Corporate structures – what is the fairest, flexible, and transparent structure that needs to be in place? 75% of the respondents said this was very difficult or difficult;
- Legal issues – What additional legal matters now need to be considered? 75% of the respondents said this was very difficult or difficult;
- Regulatory issues – how do the exchanges ensure that they are still performing their public duties equitably? 62% of the respondents said this was very difficult or difficult;
- Vested interest management – how does the exchange ensure that it continues to maintain loyalty of users? 53% of the respondents said this was either very difficult or difficult.

An interesting observation is that mutualised exchanges (see Figure 8) also consider these areas highlighted as the most difficult for a successful demutualisation.

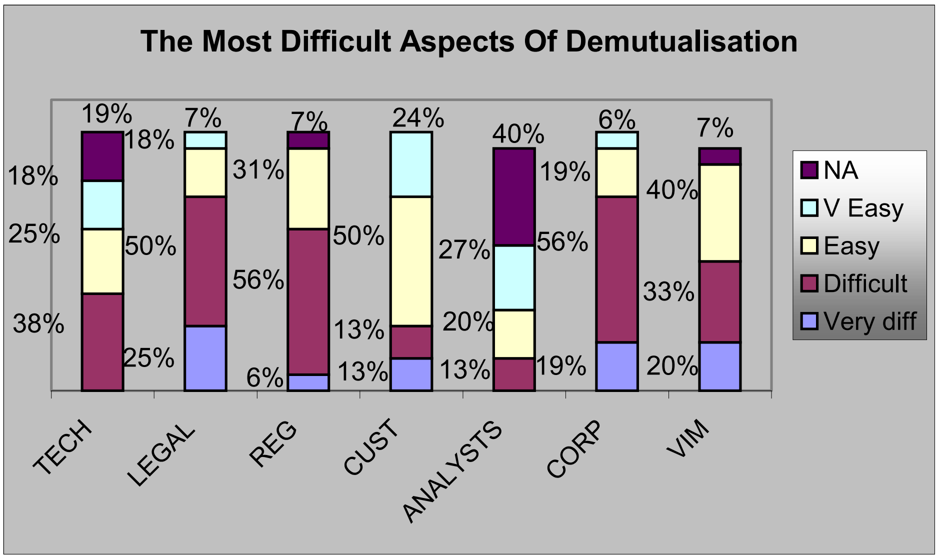

Figure 7: Demutualised Exchanges – difficult aspects of demutualisation

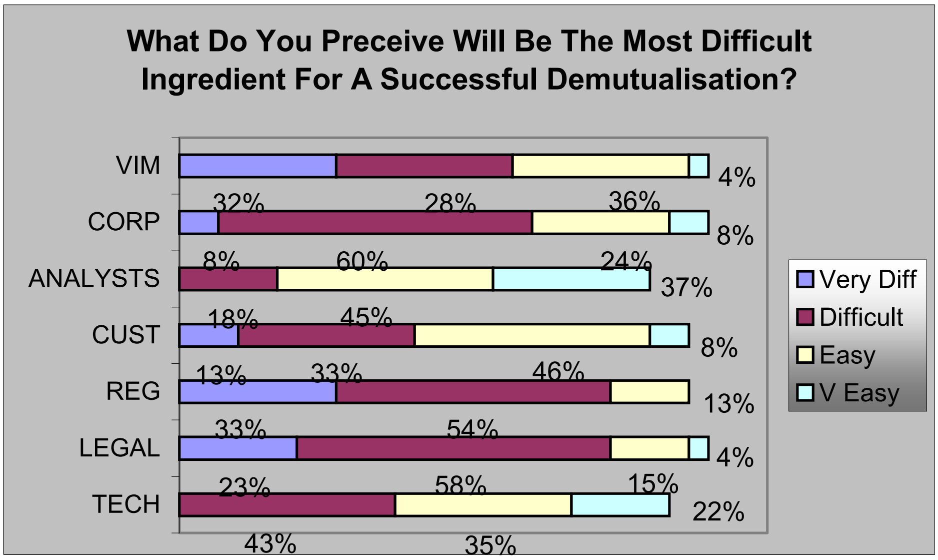

Figure 8: Mutualised Exchanges – ingredients for successful demutualisation

One of the most difficult aspects of demutualisation concerns selecting the correct corporate structure. Corporate structure is the first rung of the demutualisation ladder and will adversely affect all other stages unless the optimal solution is implemented. Because there are no blueprints, it's easy to get the wrong structure for the organisation. In considering the corporate structure, some key questions that should also be factored in are:

- What type of share structure is going to be put into place i.e. will shareholding be restricted to current members?
- Are there going to be controls put in place (either by regulators, or other government bodies) to limit the maximum percent of shares that any one entity or individual can own?
- What is the mechanism that is going to be adopted to resolve conflicts of interest between different interest groups?
- What is the composition of the operating board structure? – Non-executives, market practitioners, users, shareholders?
- Should the self-regulatory organisation (SRO) aspects of the exchange be spun off to a new organisation, or should they be transferred to the regulator?

Some of the answers to these questions are answered within this document but there is no universal solution and each exchange needs to create its own flavour.

4.2 Is corporate governance all about how many non-execs are on the board?

"A strong board is one that has a mix of vested interest and impartial non-executives"

Corporate governance is a topic that has been in vogue for much of the nineties. The Cadbury report argued strongly that there should be an increase in the proportion of non-executive directors sitting on the boards of all public companies. How should this be translated to exchanges, which many people argue are unique and should not be treated as normal commercial entities? At a minimum any corporate governance structure needs to address the following issues:

- Investor protection,
- Accountability,
- Transparency,
- Enhancing corporate performance.

Surprisingly, the corporate governance structure of mutualised exchanges (see Figure 10) closely mirrors the recommended governance structure laid out in the Cadbury report compared with that of the demutualised exchanges (see Figure 9), but this does not mean that the issues highlighted above are better managed. Usually, the non-executive directors of mutualised exchanges hail from the major players in the industry and hence its members – very incestuous. Our interpretation of Cadbury vis-à -vis exchanges is to ensure a healthy balance of vested interests and impartial non-executives.

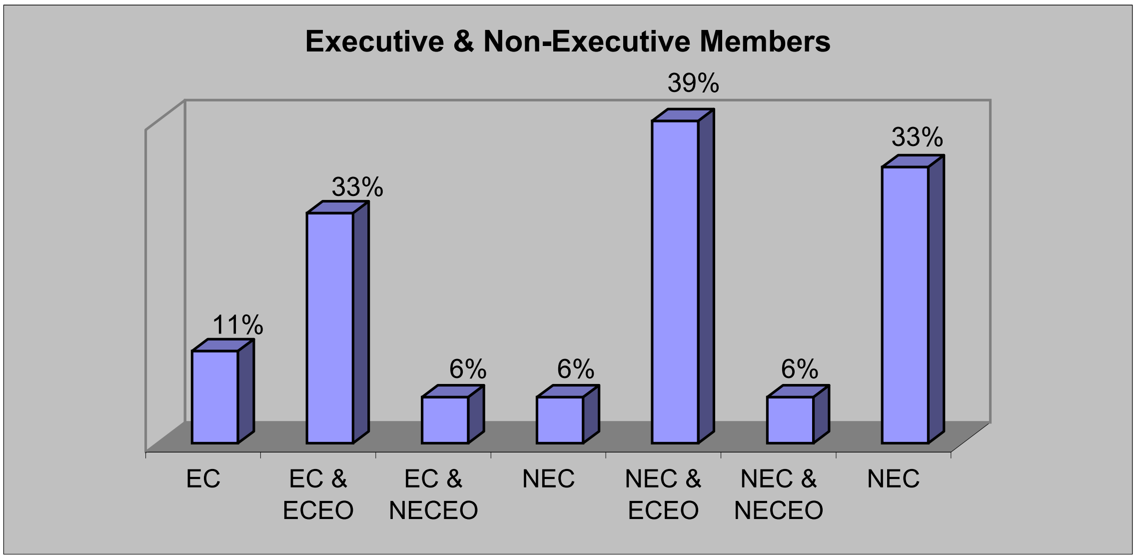

Figure 9: Demutualised Exchange: Board composition

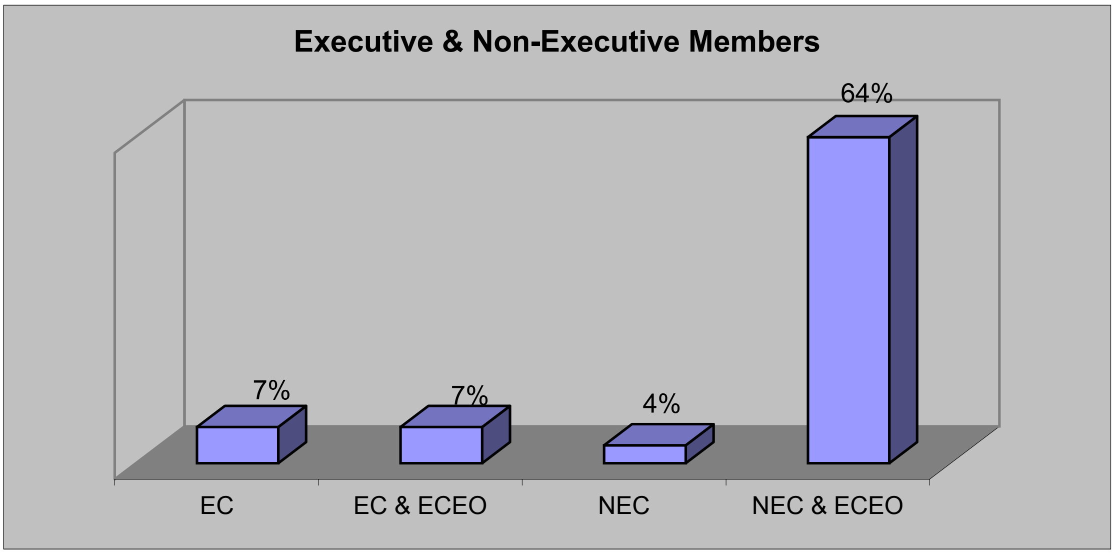

Figure 10: Mutualised Exchange: Board composition

4.3 Will a demutualised exchange continue to perform its public duty fairly?

"70% of the demutualised exchanges firmly believe that SRO aspects should still be retained by the exchanges"

In many people's minds the biggest difficulties faced when contemplating demutualisation concerns regulatory issues. This is especially true in exchanges that also act as self-regulatory organisations. The potential for conflicts of interest in a for-profit exchange are likely to be more prevalent than in a mutual exchange. Potential issues that need to be addressed include:

- The implications of self-listing - what happens if an exchange finds itself in a commercial conflict with another company listed on the exchange?
- How should primary and secondary market regulation be handled - would a for-profit exchange be less likely to enforce disciplinary action against listed companies if this would negatively affect the exchange's bottom line?
- How should a cross border relationships be supervised – regulators also want to protect themselves and their own turf. There is a danger of creating a hybrid regulator that encompasses the worst aspects of each market.
- Cross subsidisation, where funds generated from regulatory sources are used to meet commercial obligations, i.e. dividend payments, etc.
- Surveillance versus brand and the associated cost.

However, there are also strong commercial reasons that suggest demutualised exchanges will be just as diligent in enforcing regulatory rules as their mutual counterparts. There are a number of arguments that can be used to take this stance:

- A demutualised exchange that is seen to be biased or acting unethically will place its long-term viability in doubt. Brand is king, and demutualised exchanges will need to spend more money on surveillance than before.
- The uncoupling of vested interests is likely to lead to a fairer, more even handed market place.
- Although surveillance is certainly not a bottom line driven function, it could be argued that enforcement might be pursued more aggressively in a for profit exchange as a means to obtain additional revenues.

The need to adequately address SRO implications is imperative from both the regulator and exchange perspective. Exchanges cannot be expected to meet their stakeholder responsibilities when their target is constantly moving. New regulatory measures need to be designed that address the complexities of demutualisation. Considering the number of exchanges planning a demutualisation within the next 2 years, IOSCO would be well advised to issue a blueprint for regulatory management of demutualised exchanges. The scope of this blueprint would include:

1) SRO and investor protection requirements
2) Service tariffs. There is a danger of demutualised exchanges using cross subsidises thereby stunting competition, and in turn keeping the prices of some types of transactions artificially high. Some type of pricing structure will need to be installed to avoid this risk. Many lessons may be learned from public utility regulation.

The overwhelming response from demutualised exchanges (70% see Figure 11) was that SRO aspects of an exchange should stay with the exchange. Considering that most exchanges also act as SRO it is unsurprising that such a clear majority want to keep the SRO functions within the exchange. More importantly most exchanges view SRO functions as an integral part of their business and a tool for managing its users.

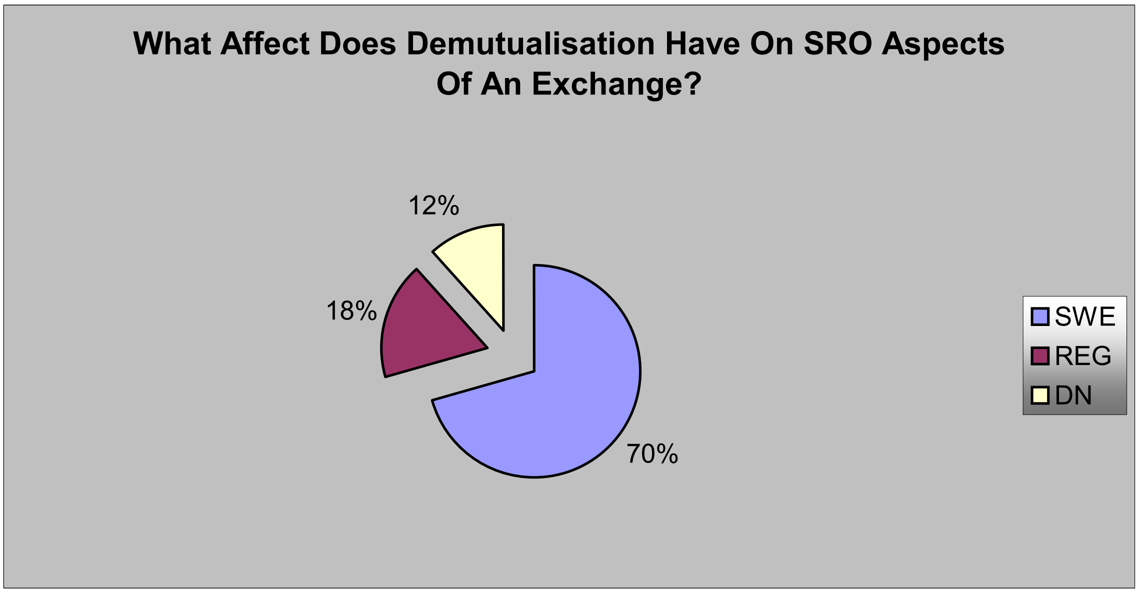

Figure 11: Demutualised Exchanges – continue to be a SRO?

Note: SWE – Stay with exchange. REG – Move to the regulator. DN – Don't know.

4.4 Retention, retention, retention

"Only 59% of the demutualised exchanges have thought about customer retention and expansion"

As surprising as it may sound, the percentage of exchanges with strategies for retaining and expanding clients post demutualisation is remarkably small. Customer Resource Management (CRM) is critical. 59% of demutualised exchanges (see Figure 12) have strategies for retaining and expanding members; 53% said the same for listed companies, and only 35% could say the same for E-clients. We are so surprised about these results – particularly the results on listed companies. This reflects the scale of paradigm shift required. Mutualised exchanges see hosted companies as only regulated contracts in the domain of the listing dept. Mutualised and indeed some demutualised exchanges do not see listed companies as customers. In such exchanges the wider value proposition for the hosted company and CRM program is in fact invisible. Exchanges are also invisible to investors, and this needs to change in the demutualised world.[3] Strategies for retaining and expanding clients varied widely. Some of the strategies included:

Members:

- Encouraging greater remote access by widening the means by which smaller players can connect.
- Lower costs, better service.
- More efficient trading systems at lower prices.
- New innovative products.

Listed Companies:

- Creating services to justify admission charges.
- Competitive fees.
- Expanding the market through alliances.
- Helping to raise capital.
- Account management programs for all customers.
- Structuring contracts to meet customer needs.
- Wholesale market facilities that enable customers to effect the trading they want.
- Increased functionality and resilience of trading systems.

E-Client:

- Looking for new markets to deploy expertise.
- New products such as a financial portal.

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[3] BTA Consulting is not proposing a wholesale disintermediation process but would expect to see investor relationship programs.

- Ability for members to provide order routing for customers over the Internet. Provisions for the widest selection of commercial front-end solutions to meet the needs of every type of customer.

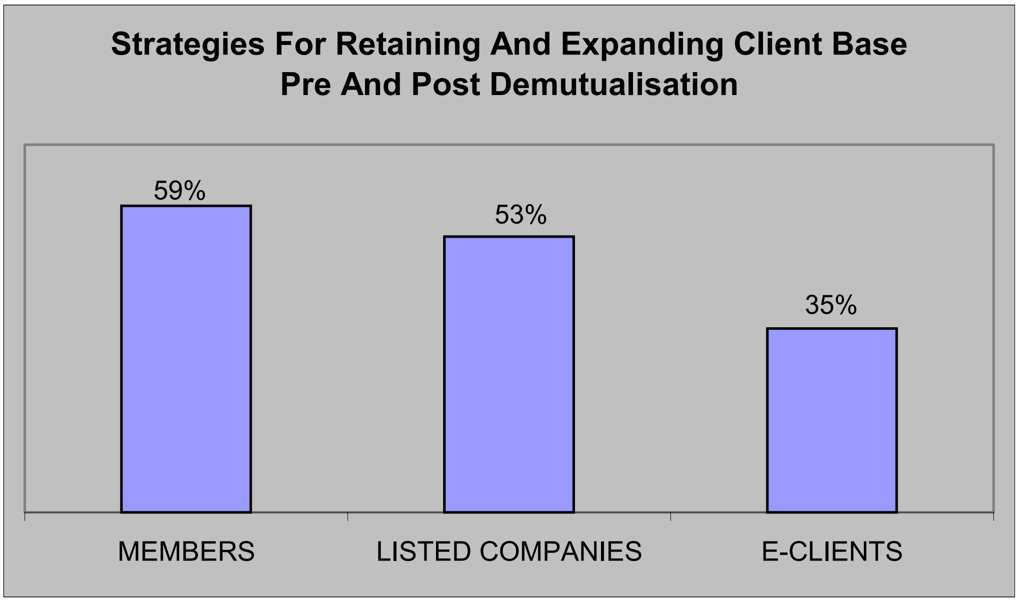


Figure 12: Demutualised Exchanges – retention of corporate assets

Again the percentage of exchanges that have employed measures to protect corporate assets in a post demutualisation environment was surprisingly low (see Figure 13). Strategies implemented included:

Employees:

- Share option schemes – but few were universal.
- Salaries.
- Reward structure based on personal and company performance.

Listings/Clients:

- Increased responsiveness to customers through management program.
- Competitive fees.
- CRM program.

Members:

- Competitive fees.
- CRM programs.
- Revised access structure/liquidity schemes introduced.

Directors:

- Challenges.
- Share option scheme performance schemes.

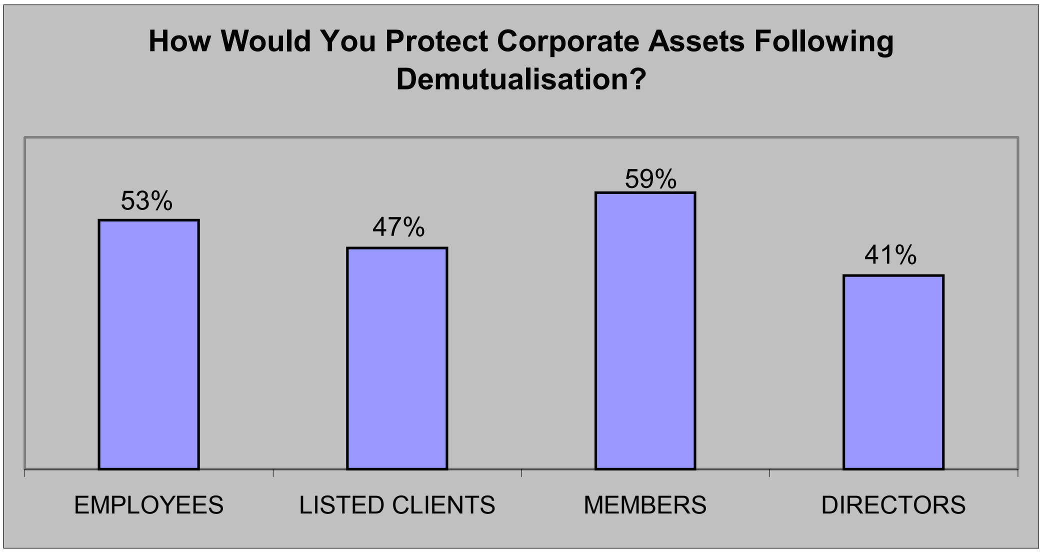


Figure 13: Demutualised Exchange - protection of corporate assets

4.5 Don't Forget About Brand Identity

"52% of the demutualised exchanges are doing something about brand erosion"

Strategies for retaining brand identity in a post-demutualised environment (see Figure14) received more attention than protecting corporate assets. Although even here, only 52% of respondents had a clear strategy to achieve this goal.

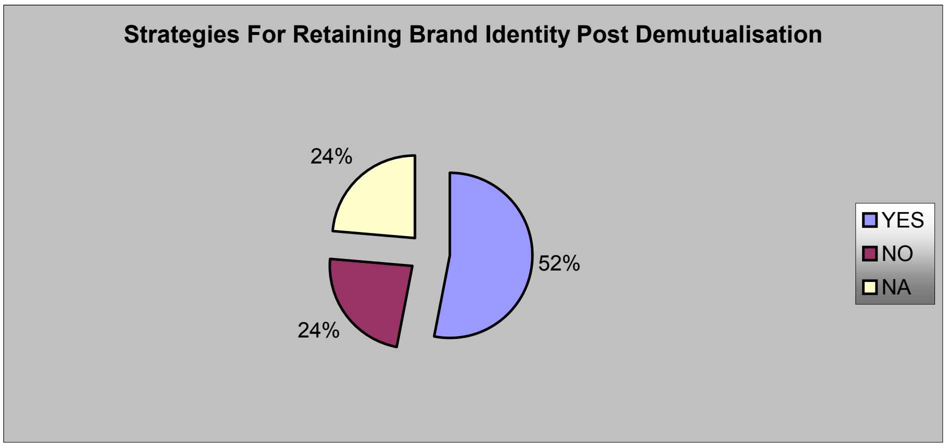


Figure14: Demutualised Exchanges - brand protection

Note: NA – No answer

52% of exchanges that have strategies for retaining and improving brand identity also said that they have implemented CRM programmes since demutualisation. These varied in complexity, and included the following:

- Offering parallel regional listing and development of newer segments.
- Shareholder visit programmes to encourage new takers and to gain support to ward off possible takeovers.
- Helpdesk for end clients and members.
- Survey of customers needs.
- E-commerce vending & solutions.
- Internet order routing.

The lack of strategy for retaining and improving brand identity post demutualisation was very surprising. A clear lack of understanding concerning the importance of brand identity was obviously absent in 48% of demutualised exchanges. Considering the huge premiums that are often bestowed (OM for example) on corporations with instant brand recognition, the absence of strategies for retaining or improving brand identity was very worrying. It would appear that although some exchanges have changed from mutual to demutual, their mindsets have not. Exchanges that fail to capitalise on their brand risk watching it slowly evaporate into oblivion.

4.6 Competition – what is that?

"88% of demutualised exchanges think that the threat to their business is from other exchanges and only 65% believe that it will stem from Internet based businesses"

Demutualisation increases the number of potential competitors and can greatly increase the complexities of operating the exchange. However, simply ignoring demutualisation and hoping that it passes you by is not an option. 88% of demutualised exchanges think that other exchanges will be the biggest treat. Surprisingly the Internet was only sighted by 65% of respondents, which might indicate a lack of foresight concerning the opportunities raised by this new medium. Again, the challenges posed by ATS/ECN has probably not been fully appreciated, especially where cross border transactions occur. ATS/ECN offer potentially huge savings by minimising inefficiencies in cross border clearance and settling the processes for international transactions.

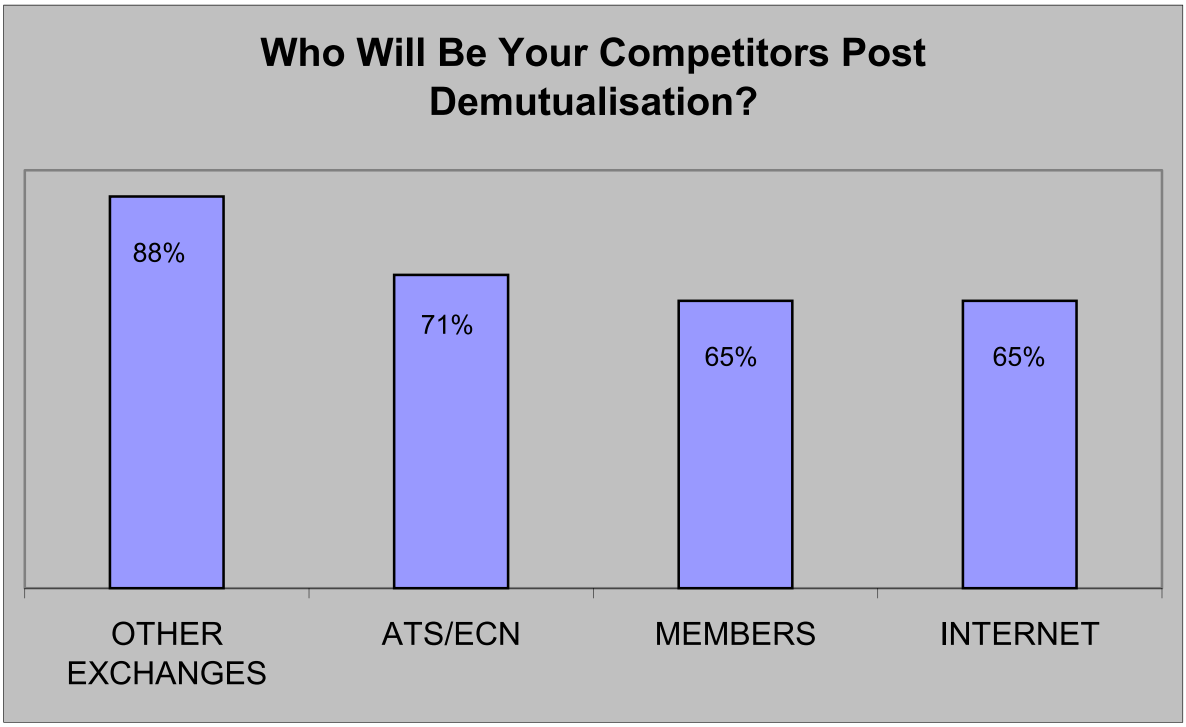


Figure 15: Demutualised Exchanges - competition

4.7 Post-demutualisation blues – the negative effects

"54% of exchanges reported no degradation or change in their external relationships"

The single biggest failure point for any demutualisation project occurs when the complexities are not fully understood. An ill-conceived demutualisation program can be damaging both financially and reputationally. Some mistakes are obviously more damaging than others. For example, launching an IPO and then realising that the share ownership structure is not the best solution for the exchange could prove disastrous.

There were a number of different negative repercussions reported by exchanges. The main ones included the following:

- Conflicts with members.
- Conflicts with advisors to the IPO.
- Regulators have changed the ball game.
- Single shareholder in another jurisdiction without knowledge of local conditions.
- Culture clash (organisation, members, personnel).

Another interesting observation noted concerned the effects of demutualisation on 3rd party relationships. Overall 54% of exchanges (see Figure 16) reported either no changes or negative changes in relationships.

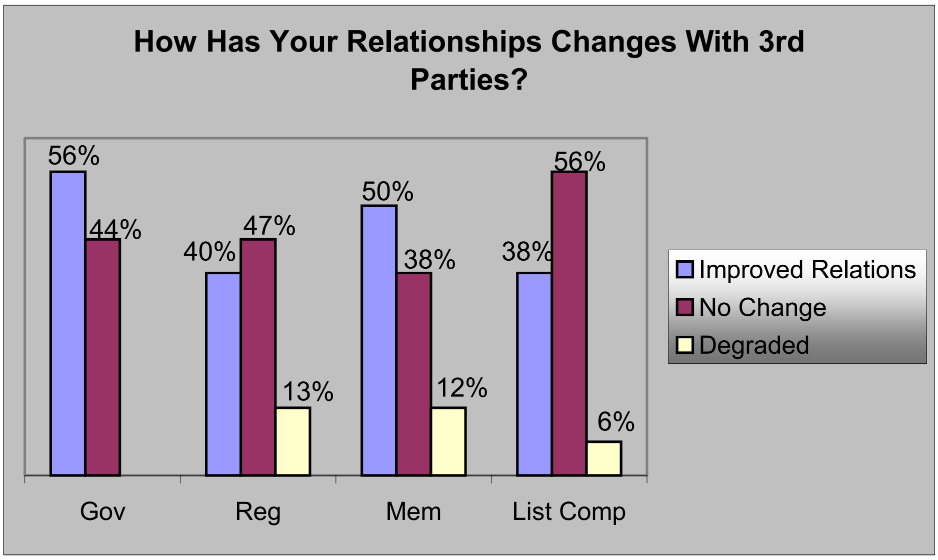


Figure 16: Demutualised Exchanges - impact on 3rd party relationships

5 Is Demutualisation all you expected?

"We were surprised by the small number of demutualised exchanges that reported the number of both financial and non-financial benefits that were actually achieved compared to their expectations"

Having been through the process of change within the organisation, it is important to understand if the results of this complex multi-dimensional process, which involves huge costs in terms of both management resources and financial costs, was as expected. We asked participants in the survey to list some the key benefits they expected to achieve by demutualising. The table below lists the main ones:

Expected Financial Benefits	Expected Non-Financial Benefits
▪ Access to greater variety of capital sources ▪ Wider customer base ▪ Improve shareholder value – payment of dividends, better relationships ▪ More profits driven ▪ Better cost control ▪ Share price improvement ▪ Increased market capitalisation	▪ More focused management ▪ Quicker decision making ▪ Freedom to pursue business opportunities unconstrained by vested interest issues ▪ Flexibility, efficiency and competitiveness ▪ Ensuring own destiny and not reliant on members ▪ Accurate means of measuring value creation by management ▪ Greater respect for company ▪ Better public relations – positive press coverage

Were these expected benefits realised? Does achieving some of these benefits mean that it was a successful demutualisation?

In our opinion, if demutualisation does not involve a wholesale change in the organisation through a planned process, it is not likely to be classified as a success story. There is a need to plan the appropriate ownership structure, governance model, relationship management, and operational management. The end result of demutualisation should be an exchange that is modelled on and performs like a Fortune 500 company.

5.1 Are you happy being demutualised?

"Only 46% of the demutualised exchanges were happy with the results of the process"

Following on from this line of questioning, the results of our survey surprised us. Only 46% of demutualised exchanges (see Figure 17) were happy with the results of the process to achieve demutualisation. The other 54% were either unhappy or said that it was too early to tell.

What went wrong? After all, demutualisation is supposed to be the Holy Grail of the exchange world. How could the exchanges be so disillusioned with the outcome?

How can the 79% of mutual exchanges surveyed that plan to demutualise within the next two years not repeat the same mistakes?

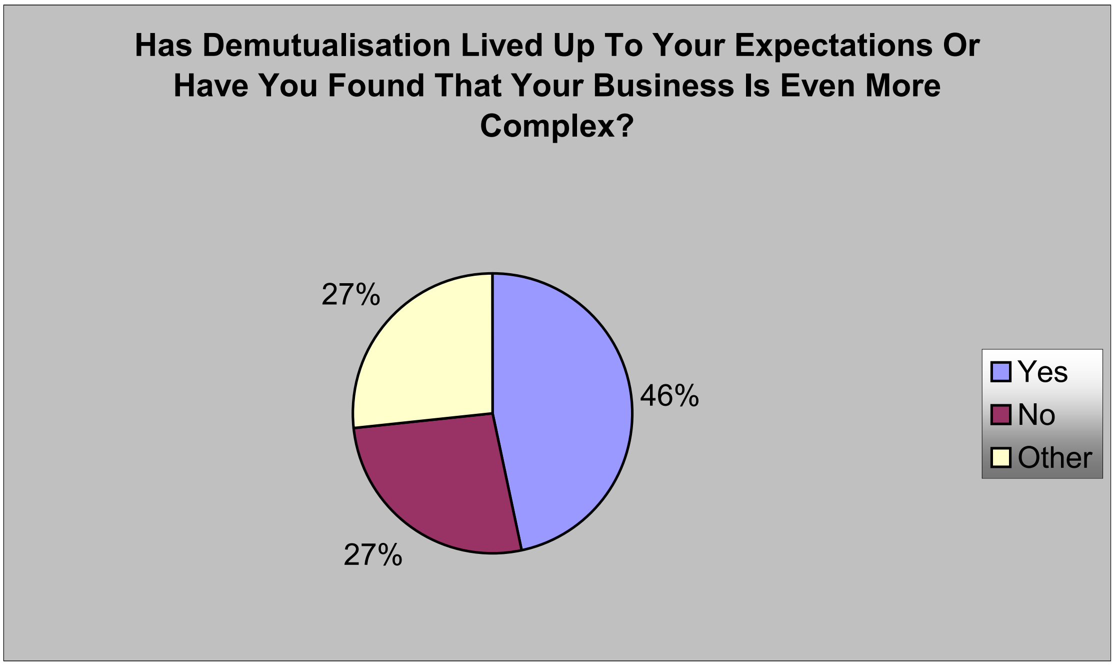


Figure 17: Demutualised Exchanges - is demutualisation lived up to your expectations?

Note: Other – Exchanges who said that it was too early to say whether demutualisation had been a success.

5.2 So what has been the historic recipe for a successful demutualisation?

"The key ingredient for success is the change of mindset"

Digging deeper, the survey results highlighted several important differences between exchanges that were happy with demutualisation, and the ones that were not.

100% of happy exchanges had a form of Listing or readily accessible public ownership. The ingredient that drove exchanges to this success was ***Mindset.*** Exchanges who experienced unhappy outcomes from demutualisation overwhelmingly behaved like a mutual exchange. The diagram below (see Figure 18) highlights the choices.

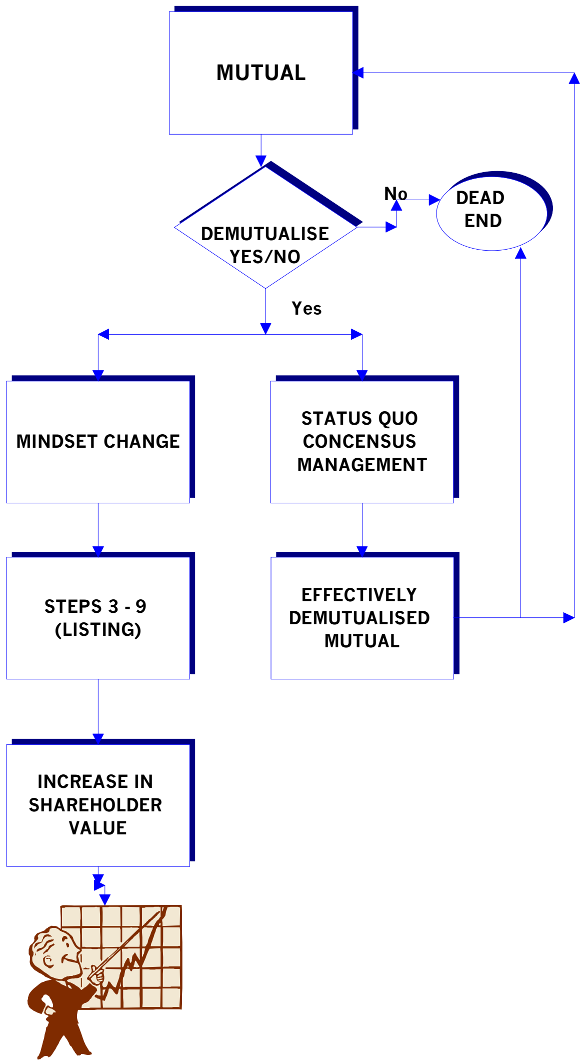


Figure 18: Demutualisation decision tree

Demutualisation is not simply an exercise in changing this of legal status, i.e. simply turning into a for profit entity owned by members. A truly demutualised exchange would be better placed if it were able to unlock its hidden value(s) for all stakeholders in order to maximise its potential market capitalisation and shareholder value.

The overwhelming majority of exchanges who have historically been happy with demutualisation recognised the importance of the following critical success factors:

- A balanced ownership structure and public listing status.
- Modern Corporate Governance.
- Stakeholder Relationship Management (SRM).
- Customer Relationship Management (CRM), in particular using modern technologies.
- Aggressive Service Level Agreements (SLA's).

BTA recognise that where success has been achieved it has been a result of appropriate corporate governance and management structures. Why? The right mix of entrepreneurial flare coupled together with an effective management teams are critical to steering the exchange towards success. Where demutualisations have neither succeeded nor created "quick wins" / positive results, these key ingredients are missing. So lets look more closely at the five critical success factors that have historically contributed to success:

5.2.1 Ownership Structure and Listing:

100% of happy exchanges are either listed or publicly tradable with few restrictions on the transferability of the shares. To get to this stage requires a necessary "Mindset Change," proving the exchange can innovate, while being flexible and transparent – so much so, that it can support the share price of the exchange by its expected future earnings. The real time price is therefore the acid test.

5.2.2 Modern Corporate Governance:

The adoption of a modern corporate governance approach is essential to create the correct environment for the growth of the business, and enhancing the value of the company for following reasons:

- To create fast tracked innovation rather than slow mutual consensus management. This is essential given mutualised exchanges have proven to be unable to respond efficiently to the needs of all stakeholders (customers, employees, shareholders, suppliers, regulators). Instead mutuals concentrate on achieving a balance within their communities, which in the demutualised world is a major problem as the focus should be on shareholder value, irrespective of the community representation.

- To create the right domestic and international image for all stakeholders, particularly given the current intensification of competition, the greater mobility of capital and the fragmentation of price discovery. Recent research has suggested that investors are willing to pay a premium, of up to 28% for shares in well governed companies in some developing countries; and

- To diversify risk and facilitate international investment, reach and branding of hitherto domestic Exchanges.

By and large those demutualisation programmes that stop at Step 3, (see appendices 1) do not pass the above corporate governance tests.

5.2.3 SRM & CRM

One of the immediate benefits of demutualisation should be improved relationships with external parties, particularly through the introduction of SRM programmes and CRM software. The differences in relationships experienced by the happy and unhappy exchanges were massive. 61% of happy exchanges (see Figure 19) enjoyed improved relationships with 3rd parties. This compared to 63% of unhappy exchanges that did not enjoy any improvement in 3rd party relationships. This failure to immediately achieve improvements with stakeholders is probably a good indication of future problems for demutualised exchanges.

The exceptions to this rule are Regulators. BTA Consulting believe that demutualisation will not automatically be followed by improvements in relationships with governmental entities, particularly where Governments force a public policy role on the exchange. Regulators are not sufficiently attuned with their role in the post demutualisation era. As we explained earlier they are creating a moving target by continually changing the ball game, which is particularly unhealthy.

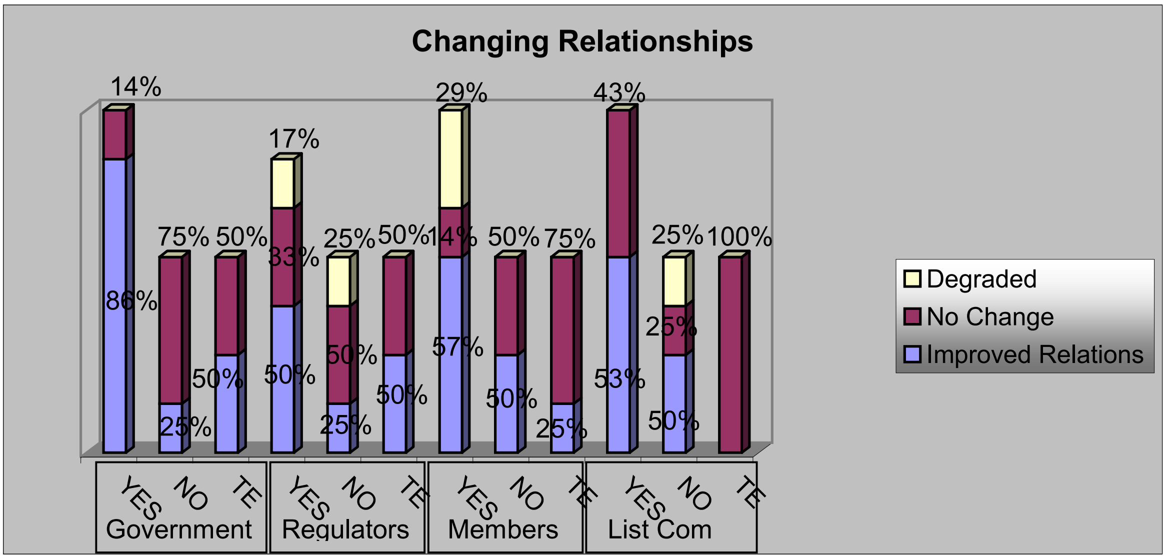


Figure 19: Demutualised Exchanges - status of relationships

Note: YES – Exchanges who were happy with demutualisation. NO – Exchanges that were unhappy. TE – Exchanges that said it was too early to tell.

5.3 Commercial Entities Need SLA's (Service Level Agreements)

"33% of the demutualised exchanges have implemented aggressive SLA's – this is surprisingly high considering that the exchanges are still in mutual mode"

Quite surprisingly only 33% of demutualised exchanges have implemented more aggressive SLA's (see Figure 20). We were surprised to see this was so high. However, the percentages of happy exchanges that have implemented more aggressive SLA's are clearly much higher than average, and considerable higher than unhappy exchanges. The competitive playing field for exchanges will be critically dependant upon SLA's - and will be a way to attract and retain clients on a long-term basis.

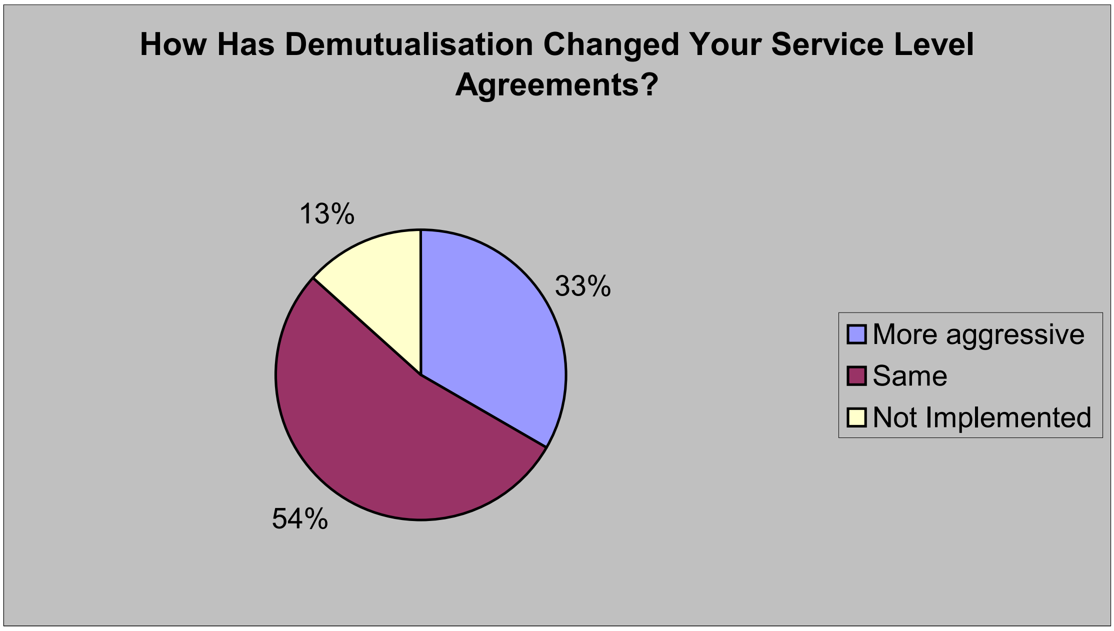


Figure 20: Demutualised Exchanges – changing SLA's

58% of happy exchanges (see Figure 21) have implemented more aggressive SLA's. 67% of unhappy exchanges have not implemented more aggressive SLA's, and 100% of exchanges that said that it is too early to tell have also not implemented more aggressive SLA's.

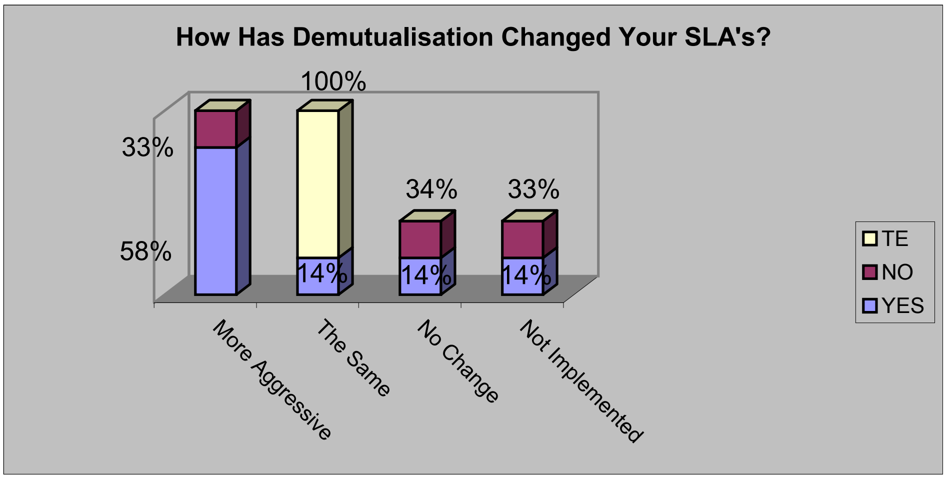


Figure 21: Demutualisation – improved SLA's = happy exchanges

So will the past be representative of the future? Will the 79% of exchanges that are considering demutualisation in the next two years, or who are considering moving from Step 2 through to Step 9, be successful if they focus on the 5 critical success factors discussed in this section. Sadly, the answer is No, and you need to read on, to consider the new success factors that are looming on the horizon.

5.4 Is the past representative of the future?

"With 79% of exchange demutualising over the next 2 years – they only have one shot at getting it right"

BTA Consulting has analysed these results and has also used its considerable experience and vision to consider the impact on both mutualised and demutualised exchanges. Our belief is that the past will not be representative of the future. Accordingly, some key lessons need to emerge. Successful demutualisations that lead to successful IPO's and a growth of shareholder value, will in the future be dependant upon other additional critical factors:

1. Being right first time – the novelty factor for demutualisations is wearing off and the market for exchange shares will soon be saturated. Can the markets absorb in excess of $50 billion of exchange shares in the next 2 years? In this context, the demutualisation needs to be right first time, and needs to escalate to Step 9 of the BTA Methodology very quickly. If the demutualisation programme stalls around Step 3, then it will take significant capital and time to recover the market capitalisation of the demutualised company.

2. Timing – there is going to be a saturation of exchanges on the global market and they will also be competing with some interesting B2B, B2C, and C2C markets. Therefore, the 79% of exchanges planning a demutualisation within the next two years need to undertake this sooner rather than later, and need to move to step 9 quickly. Demutualising around the end of 2002 may be either too late, or may reduce shareholder value.

3. Service offering – the exchanges need to offer a compelling value proposition that will support an IPO and future Price / Earnings ratios. In the context of growing competition, our opinion is that exchanges will need to diversify their businesses, become niche, and/or become vertical silos that embrace settlement. The value of price discovery and market data, the traditional revenue generators of exchanges, will in the medium term be minimal as they are quickly becoming a commodity,
4. Where to List? The "backyard" may not be the only serious location to consider. Competition would normally dictate significantly more aggressive cross – border strategies.
5. Widening the scope of CRM programmes – in the future these will need to be electronic, and in this world where the Internet offers a new complimentary channel to market, the CRM programmes need to embrace ISP type technologies.

6 Conclusions

The cosy world of the mutualised exchange has now been superseded by the commercial realities of the 21st century. Flexibility, innovation and mindset changes are the new winning ingredients. Exchanges that fail to adapt to this new environment risk the same fate as the dinosaurs. Demutualisation is now viewed as the panacea for all the woes inflicting mutual exchanges. Although the allure of demutualisation is not universally accepted, 79% of mutual exchanges interviewed plan to demutualise within the next two years. A survey taken at the Oct 2000 FIBV conference found that 78% of exchanges either had approval to demutualise or were actively considering it. Timing to list has now become critical. First mover advantage has now been lost. Exchanges only have one shot at demutualisation.

Demutualisation can, and does offer unprecedented opportunities. But only for exchanges that tackle the whole process in a systematic fashion, where the end result is a structured organisation that is:

- Transparent to its shareholders, management and staff and its users.
- Truly segregated - stakeholders (users and shareholders) from the management of the business.
- Governed by a board with non-executive and executive directors.
- Capable of delivering sustainable value without cross subsidies.

When demutualisation only takes the form of a legal manoeuvre leading to a for profit entity, the results are overwhelmingly a failure. Exchanges that successfully manage the necessary structural changes but continue to act as a mutual are also doomed to failure. A poorly conceived demutualisation plan can be costly both in terms of brand erosion and financial leakage.

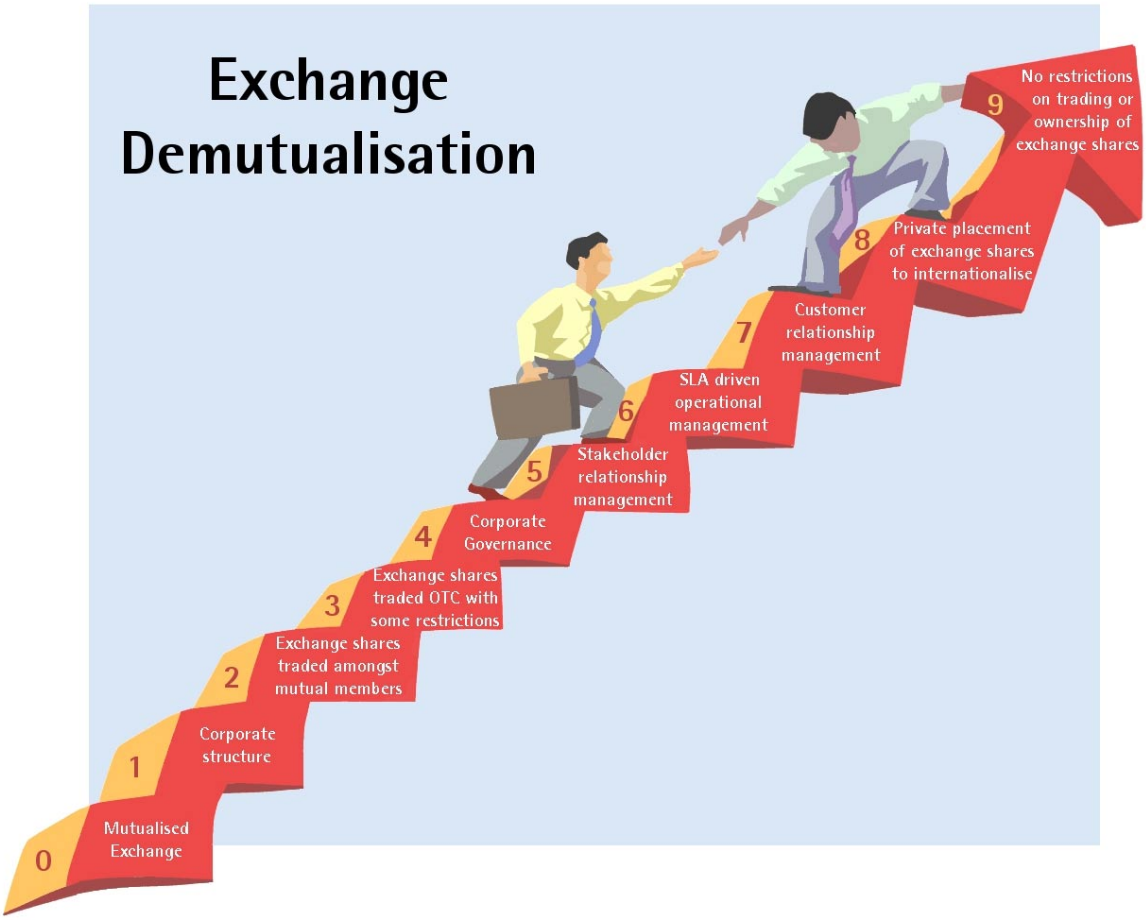
There is a clear distinction between exchanges that reported being satisfied with the outcome of demutualisation and those that where not. Exchanges that were listed and aggressively tackled all the areas encapsulated in core competencies and value added services such are SRM and CRM reported a significantly higher satisfaction rate than exchanges that did not.

With the exception of a few exchanges, demutualisation has really only been in vogue for the last several years and therefore as more exchanges move towards demutualisation it will be interesting to see how many have learned from the mistakes of others. We believe that by following the 9-step approach developed by BTA Consulting these mistakes can be avoided.

Interestingly, in order to get a more quantitative measure of the success of an exchanges demutualisation programme, an exercise should be undertaken to map the improvement in the exchange's market capitalisation against its progression along the 9-step programme to determine whether it is a success or not.

Appendix 1

BTA Consulting Demutualisation Methodology



Appendix 2

The results from questions that dealt exclusively with BTA's Demutualisation Methodology are discussed in this section.

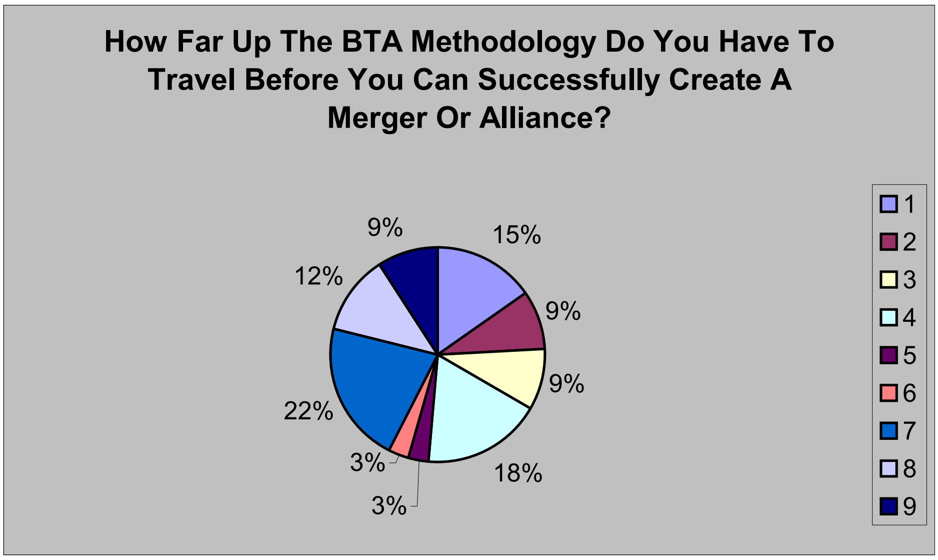
Mutual Questionnaire Results

Question 6 – How far through the BTA Methodology do you have to travel before you can successfully create a merger or alliance?

Verdict and BTA's comment

Interestingly there was no consensus regarding the entry point for pursuing mergers or alliances. Step 7 received the largest percentage of respondent's votes, which was quite puzzling. Although different stages can be implemented in parallel, and indeed should be, it's difficult to see the logic in attempting to run before you can walk. In order for an alliance or merger to be successful, the areas covered in steps 1 through 4 needs to be fully addressed. Only 51% of respondents picked either of these steps. Corporate structure is the foundation stone for all successful alliances and mergers. Failure to adequately tackle the often-complex issues surrounding corporate structures will inevitable lead to an outright failure, or at best a corporate structure that is not optimally designed for success. Steps 2 through 4 also need to be addressed before the right mix can be achieved for successful alliances or mergers.

Figure 22: Mutual Exchanges – mergers & alliances

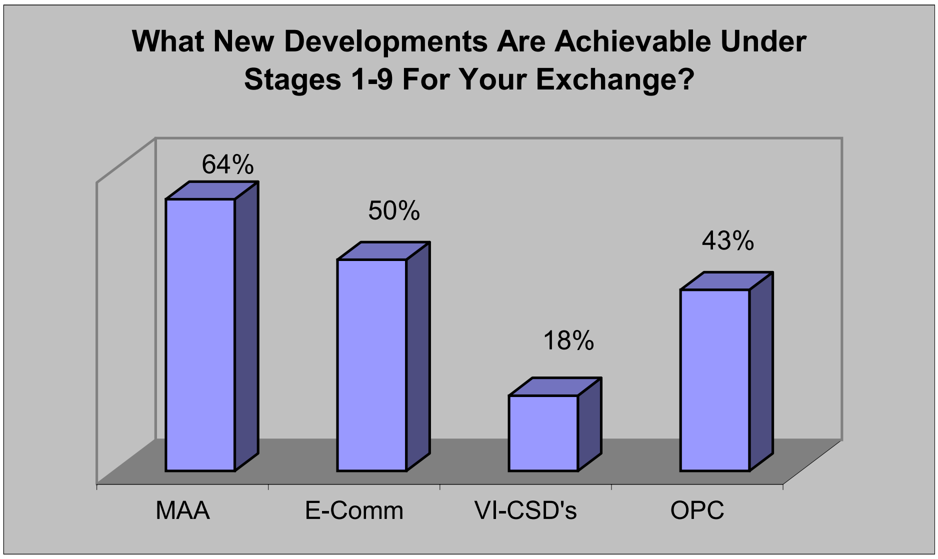


Question 7 – What new commercial developments do you believe are achievable for your exchange under stages 1-9?

Verdict and BTA's comment

It was not surprising that MAA was the single biggest category nominated for new opportunities under stages 1- 9. After all at right mergers or alliances seem to be the order of the day for exchanges worldwide. We were very surprised that e-commerce opportunities did not draw as much attention as would be expected considering its potential. This could be an indication that either exchanges do not fully grasp the challenges posed by new online entrances, or believe that the threats have been over exaggerated.

Figure 23: Mutual Exchanges – new opportunities

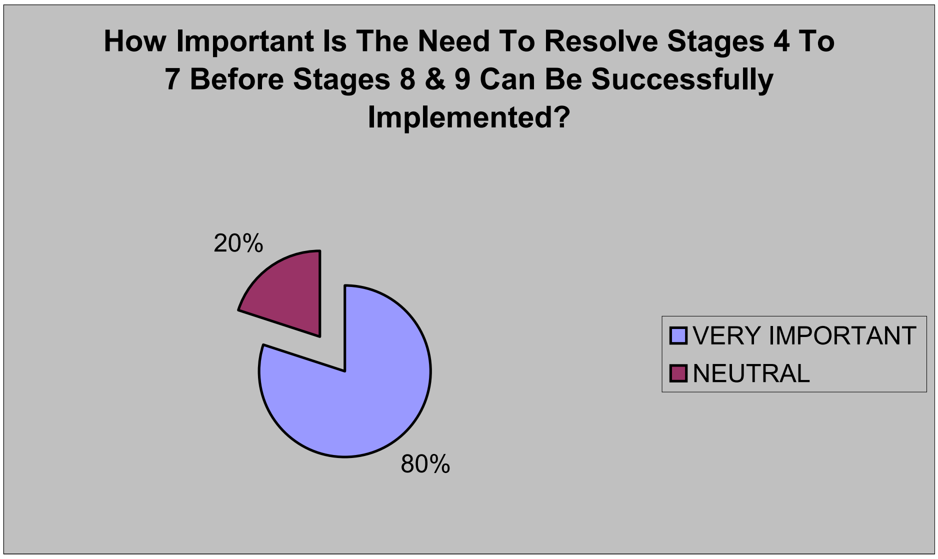


Question 8 – How important is the need to resolve stages 4 to 7 inclusive i.e. corporate governance, stakeholder relationship management and operational management issues before stages 8 & 9 can be successfully implemented?

Verdict and BTA's comment

It was very interesting that the percentages of mutual exchanges who realised the importance of steps 4 – 7 was actually higher than that for demutualised exchanges. This is a very good omen for mutual exchanges as they embark on the demutualisation highway. Our survey clearly shows that exchanges that understand steps 4 – 7 and acted to address the issues raised, experience a much higher percentage of happy outcomes from demutualisation.

Figure 24: Mutual Exchanges – the importance of stages 4 to 7

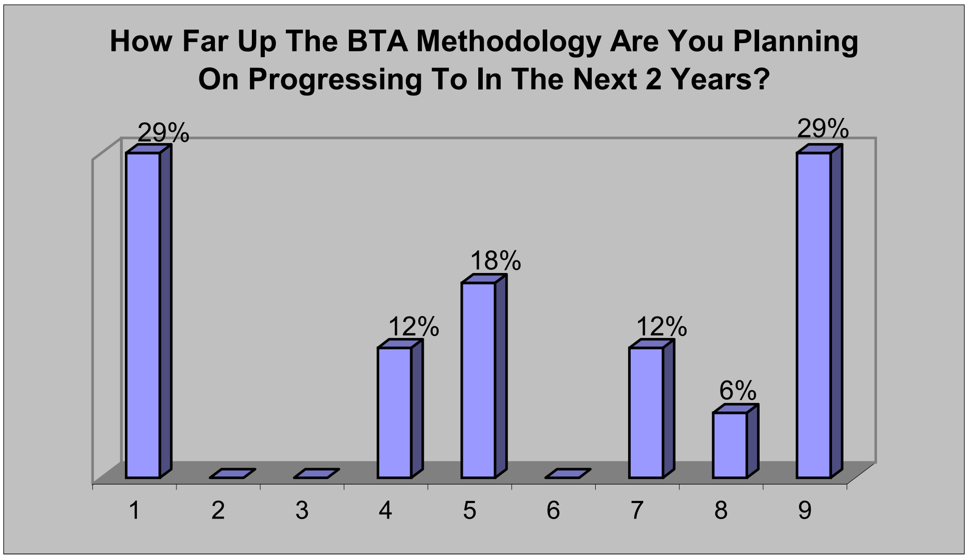


Question 9 – How far up the BTA Methodology are you planning on progressing to in the next two years?

Verdict and BTA's comment

Surprisingly the two biggest concentrations of answers were for stages 1 and 9. This either indicates that 29% of exchanges have very aggressive demutualisation plans, or they do not really understand the challenges posed to successfully reach stage 9. Of course the flip side of the coin is that exchanges who only plan at being at stage 1 risk falling into the unhappy category of exchanges. Demutualisation does not stop at stage 1, and exchanges that are planning on stopping here have probably made the mistake of creating a legal demutualisation e.g. one in name only, and not a commercial one.

Figure 25: Mutual Exchanges – future progression

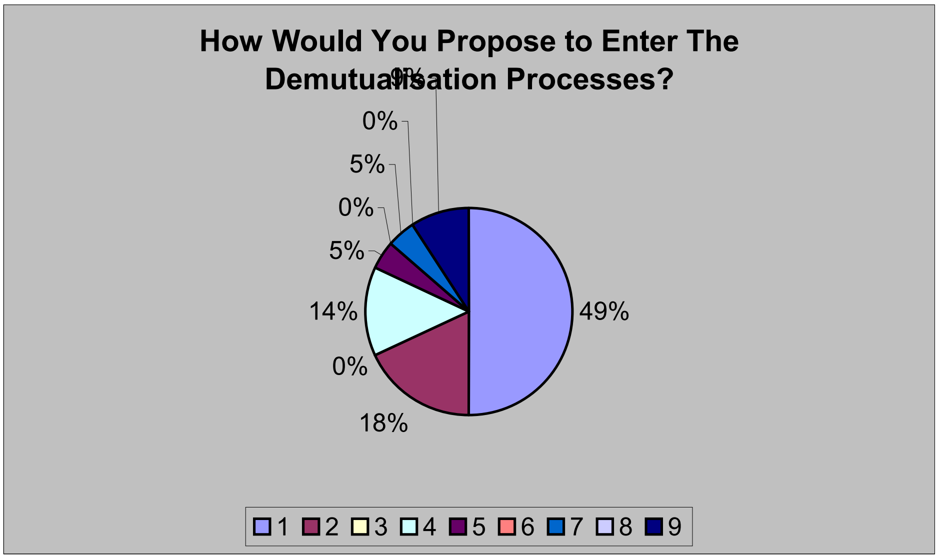


Question 10a – How would you propose to enter the demutualisation processes if you attempted to demutualise? Which stage would you follow and why?

Verdict and BTA's comment

It was very reassuring to see that by far the largest category chosen was step 1. Demutualisation, like all structures, needs to have sound foundations in place to weather the storms ahead. Stage 1 is the lynch pin for constructing a sound structure. However, this does not mean that other stages cannot be run in parallel. In fact in most instances it is commercially desirable to collapses the demutualisation process by running multiple stages in parallel.

Figure 26: Mutual Exchanges – entering the demutualisation process



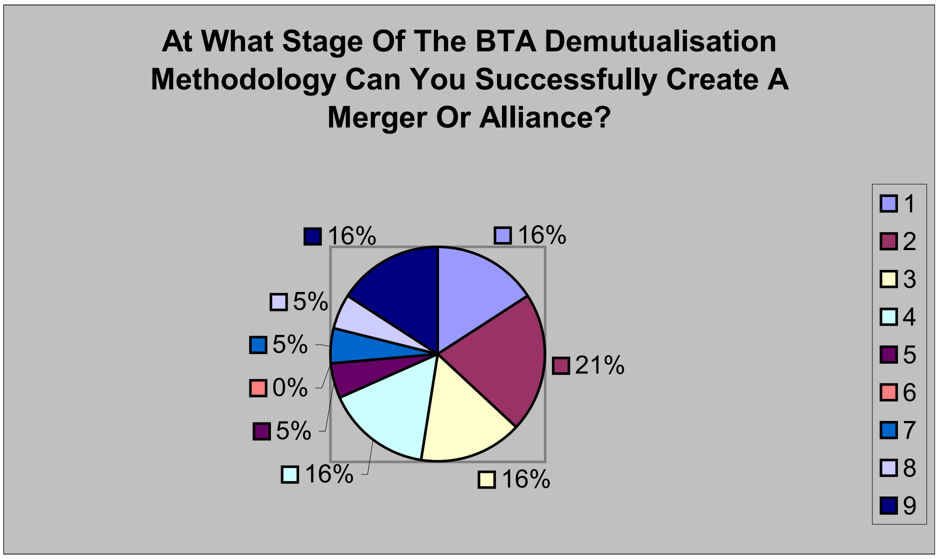
Demutualised Questionnaire Results

Question 4 – What new commercial developments do you believe are achievable for your exchanges under stages 1- 9?

Verdict and BTA's Comment

In order for an alliance or merger to be successful, the areas covered in steps 1 through 4 need to be fully addressed. 69% of respondents picked one of these steps. Corporate structure is the foundation stone for all successful alliances and mergers. Failure to adequately tackle the often-complex issues surrounding corporate structures inevitable lead to an outright failure, or at best a corporate structure that is not optimally designed for success. Steps 2 through 4 also need to be addressed before the right mix can be achieved for successful alliances or mergers.

Figure 27: Demutualised Exchanges – successfully creating mergers & alliances

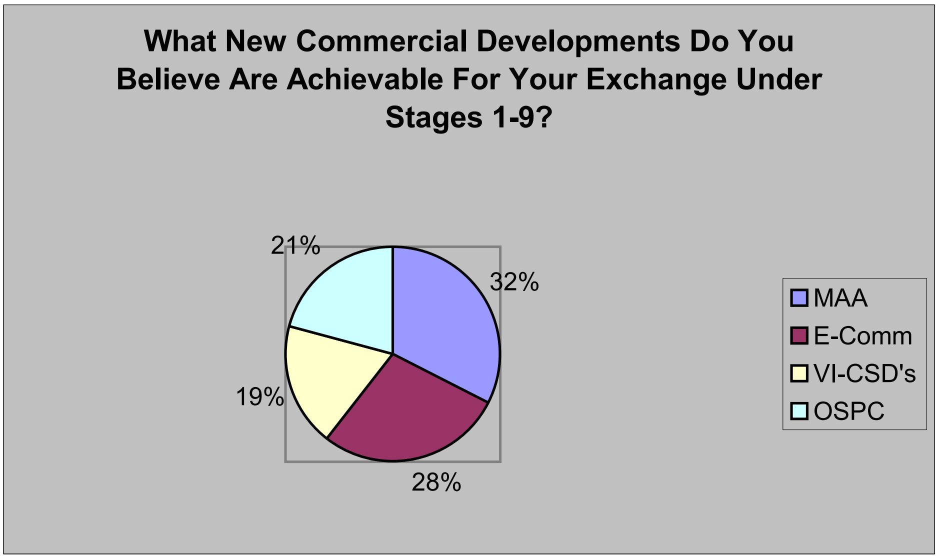


Question 5 – What new commercial developments do you believe are achievable for your exchange under stages 1– 9?

Verdict and BTA's Comment

Although it was not surprising that MAA was the single biggest category nominated for new opportunities under stages 1- 9, it was very surprising that opportunities like e-commerce and outsource provision for customers received so much attention. Both of these opportunities should already be available to dynamic mutuals (if of course there is such a creature). The lack of, or perceived lack of, opportunities surely is the death nail for the mutual industry? It's difficult to see what long-term prospects are open to mutual exchanges when so many recognize the limitations imposed by a mutual structure.

Figure 28: Demutualised Exchanges – new commercial opportunities



MAA – Mergers, acquisitions and alliances. E-Comm – E-Commerce initiatives.

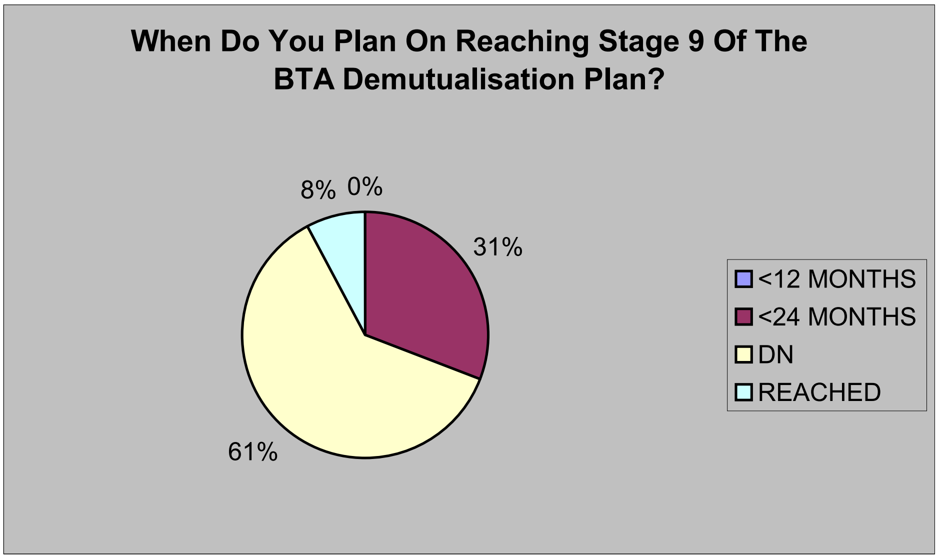
VI-CSD's - Vertical integration with CSD's. OSPC – Outsource service provision for customers

Question 20 – When do you plan to reach stage 9 of the BTA demutualisation plan?

Verdict and BTA's Comment

It was not to surprising that such a large percentage of exchanges did not know when they were planning on reaching stage 9, i.e. no restrictions on ownership of exchange shares. In many people's minds, exchanges are unique animals that need special restrictions placed on ownership. There are plenty of arguments that can be made to justify any given stance in this area. However, no matter what ownership structure is pursued, it's important to remember that exchanges that were not listed exclusively fall under the unhappy or too early to tell umbrella in our survey.

Figure 29: Demutualised Exchanges – reaching the top of the mountain



About BTA Consulting

BTA consulting is the leading specialist consultancy in the capital markets arena, with a wealth of consulting and interim management experience in stock exchanges, central depositories, banks and online initiatives. BTA Consulting offers a range of services to ensure success for its clients. New ideas dominate the world of financial services today. What was relevant yesterday, or today, will no longer be relevant tomorrow. BTA Consulting has an unsurpassed understanding of international competition, deregulation and technological innovation, to enable our clients to make real break-throughs. We continually re-appraise fundamental assumptions to deliver excellence! With a complete multi-disciplinary team of experts in strategy, technology, project management, executive leasing and legal/regulatory fields, BTA Consulting has accumulated an impressive list of recent and past mature market blue chip, as well as emerging market cliental such as:

Exchanges and Central Depositories

- LIFFE
- OM Gruppen
- JiWay
- SIA (Borsa Italiana/ EuroMTS, MTSJapan)
- Keler, Budapest, Hungary
- Budapest Stock Exchange
- Malta Stock Exchange
- Oslo Børs
- Ministry of Finance - Czech Republic
- Polish National Depository
- Bahamas International Securities Exchange
- Bahamas Financial Service Board
- Cyprus Stock Exchange, Cyprus
- Czech Securities Market (RM-S), Czech Republic
- Slovak Securities Market (RM-S and BOB), Slovenia
- Estonian Central Securities Depository
- Kuwait Stock Exchange, Kuwait
- Abu Dhabi Stock Exchange, Abu Dhabi
- Bombay Stock Exchange, India
- OTC Exchange, India
- Icelandic Securities Depository
- Bahrain Stock Exchange
- Malaysian Central Depository
- Nairobi Stock Exchange/Capital Markets Authority
- Argenclear

System Integrators and Solution Vendors

- Stratus
- Perot Systems
- EFA Software
- CMA Small Systems
- Cable & Wireless, UK
- Cable and Wireless, British West Indies & UK
- Cable & Wireless, UK
- MINT/Stratus/S2 Systems
- HP
- S.W.I.F.T S.C.
- Syntegra – British Telecom Plc
- Systar SA – France
- TCAM Systems Limited (now part of OM)
- Batelco, Baharain

Investment Banks & Brokers

- Merrill Lynch
- Dresdner Kleinwort Benson
- Alpha Group, Athens, Greece
- E*Trade
- UBS London and Zurich
- AIB Dublin
- Bank of Ireland
- Rabobank

Other

- CNBC
- IIR limited

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