Journal of Economic Cooperation **24**, 4 (2003) 1-32

STOCK EXCHANGE ALLIANCES AND POSSIBLE METHODS FOR ESTABLISHING A UNION OF ISLAMIC STOCK EXCHANGES AND CLEARING HOUSES

SESRTCIC

In today's world, the markets in America, Europe, and the Asia/Pacific dominate the world's financial markets. For this reason, there is a need for the OIC community to establish its own stock exchange and securities alliance to be able to compete with those giants. The paper first introduces the basic concepts and the logic and functions of stock exchange alliances. Then it provides a description of the selected international stock exchange alliances and their structures and operation procedures with the purpose of drawing lessons to benefit the proposed OIC alliance. After briefly discussing mutual trading models among securities markets, the paper proposes a model to establish an alliance among the OIC stock exchanges based on the material discussed in previous sections.

1. INTRODUCTION

Globalisation and the rapid integration of world markets have been most evident in world capital and financial markets[1]. They have also been the main forces driving the process of change in these markets. With globalisation, major institutional investors have moved massively into portfolio and equity investment on a cross-border or global basis.

To cope with the recent global transformation, financial and capital markets have been engaged in a rapid process of change to secure and consolidate their positions and to face up to the challenge posed by globalisation. Stock exchanges too, as integral institutions in international finance, have been going through a similar process of adjustment. The different forms of stock market alliances that have been taking place recently are among these adjustments. The alliances take the forms of mergers and take-overs in some instances, and unions and

[1] Regulated markets and any other securities and derivatives markets recognised, regulated or supervised by the Authorities.

federations in others. The form, rigour, speed and volume of change invariably reflect the level of advancement and organisation of the stock markets themselves beside the state of development of the host economies.

Since a stock exchange is a regulated market involving different actors and mechanisms, it plays a crucial role in developing financial markets. Stock exchanges broaden investment opportunities around the world. Nonetheless, some constraints exist for them. In this context, stock exchanges worldwide are faced with challenges to provide a high-quality service to market participants like intermediaries, market organisers, companies and investors. Moreover, public and private agents in their jurisdictions play an important role in strengthening the ties among them.

On the other hand, in today's world, the markets in America, Europe and the Asian/Pacific rim dominate the world's financial markets. In essential aspects, the three regions carry roughly the same weight. For others, however, to have a foothold in these increasingly integrated and concentrated markets, there is a need to co-operate among them and to form their own alliances.

Forming alliances and establishing links among stock exchanges can be done through a variety of ways and means. Mostly, mechanisms depend on the functionality and capacity of existing stock exchanges to provide these links. Furthermore, infrastructure providers, such as energy and telecommunications utilities and the banking sector, play a crucial role in supporting these mechanisms. On the other hand, forming alliances and establishing links among stock exchanges assume important responsibilities for competent authorities in member countries. This will include the creation of a regulatory framework for supervising these markets and making the necessary changes in national legislation. In this regard, the harmonisation of physical, institutional and legal frameworks will play a key role in consolidating these markets in the participating countries.

Moreover, stock exchanges in member countries should adopt a common set of rules and standards in listing companies, clearance and settlement processes, and require listed companies and market intermediaries to comply with them.

Examination of methods and mechanisms pursued by existing regional alliances of stock exchanges will be a suitable starting point in seeking a mechanism to establish an Islamic stock exchange and clearing union. For this reason, this report starts with surveying the experience and structure of current international stock exchange and securities alliances with the purpose of drawing lessons to benefit the proposed OIC alliance. The samples of institutions considered are the most reputable and influential worldwide. They also represent a real cross-section of the current spectrum of institutions working in the world today. Thus, together, they represent an abstract of contemporary human experience in this field. Based on their experiences, OIC countries may discuss the feasibility of these alternative models and agree on a possible mechanism in this regard.

The Report is structured as follows: Section two gives a general background on the matter introducing basic concepts and the logic and the functions of stock exchange alliances. Section three contains a brief description of the selected international stock exchange alliances and their structures and operation procedures. Section four briefly discusses mutual trading models among securities markets and Section five proposes a model to establish an alliance among the OIC stock exchanges based on the material discussed in previous sections.

A statistical annex[2] is included to reflect the state of development of the main OIC capital markets *vis-à-vis* Developing, Emerging and Developed Markets.

2. BACKGROUND

Stock exchanges and clearing houses have been among the basic and central institutions of capital and financial markets which also perform the most central role and functions in an economy. The two institutions were created during the last century as vehicles and intermediary bodies through which investors meet and interact. In addition to their conventional objectives, contemporary exchanges perform many more functions than the ones for which they were originally contrived.

---

[2] Adapted from the International Finance Corporation (IFC) Emerging Stock Market Factbook 2001.

Stock exchanges are specialised, centralised and organised markets designed purposely for the trading of the financial securities listed within them. They may be of two forms, incorporated institutions or voluntary associations of members. In either case, however, they include a legal framework, a constitution, a charter, by-laws, and rules and regulations that govern their membership, listing, trading and other organisational and operational matters. Exchanges do not trade in the listed securities; they merely provide the facility for trading. They are institutionally justified by their function of facilitating marketability in their listed securities. This is done by providing trading facilities and publicity to volume and prices, and by requiring the corporations whose shares are listed to observe proper standards of accounting and reporting, thus enhancing public confidence in the market and in its listed securities (Glenn 1984, p.893).

The most essential function of stock exchanges is, as it has always been, to offer to the owners of enterprises the opportunity to raise new capital and, hence, build substantial joint companies. The capital of enterprises represents the savings of individuals. Exchanges provide the investor with the means of investing his or her savings whilst retaining their liquidity. Savings of individuals are precious, and it is necessary that they be protected. Exchanges, therefore, include in their functions the publication of timely information from issuers so that investors can be properly informed about the enterprises whose securities they invest in and the process whereby prices for those securities are struck. It is essential, therefore, both for fairness and for economic efficiency, that all exchange functions, including the setting of stock prices, are determined in a transparent way. Therefore, the central functions of stock exchanges revolve around adapting stock exchange conventional roles to the challenges posed by technology and the globalisation and institutionalisation of markets.

Stock Clearing Establishments or Houses (SCHs) are corporations often formed by members of a stock exchange to provide them with facilities of clearing transactions in securities, including netting out contracts between members, delivering securities and handling payment for them (Walmsley 1979, p.234). All leading and fully-developed exchanges in the world have their own clearing houses and mechanisms. However, some exchange markets do not have their own clearing systems and mechanisms and, thus, use other leading markets' SCHs as standards and vehicles for their operations.

The process of settling a transaction is closely related to the functioning of clearing and settlement systems. Once the terms of a securities transaction are confirmed, the respective obligations of the buyer and seller are established and agreed. This is part of a series of steps involved in the process of completing the transfer of ownership of the securities and the corresponding payment.

Delivery of securities and payment of funds may occur simultaneously but only when both delivery and payment have been finalised, settlement of the securities transaction is completed. Essentially, for a settlement to occur, the following steps need to be accomplished (EU's Web Site, 2001, p.4):

Confirmation of the terms of the trade as agreed between the seller and the buyer;

Clearance, by which the respective obligations of the buyer and seller are established;

Delivery, requiring the transfer of the securities from the seller to the buyer;

Payment, requiring the transfer of funds from the buyer to the seller.

Settlement is a service normally provided by a clearing house, a Central Securities Depository (CSD) or an international CSD (ICSD), when there is not any established clearing system and/or mechanism in the country. A Central Securities Depository immobilises physical securities and transfers their ownership by means of book entries in electronic accounting systems. In some cases, a Central Counter-Party (CCP) interposes itself between buyers and sellers, becoming, in effect, a buyer to every seller and seller to every buyer, which is known as novation. In this case, both buyer and seller should be members of these systems.

Clearing and settlement institutions may also operate in various locations as modern technology makes it easily possible. Similarly, direct remote access to national clearing systems is also technically possible if it does not face any barriers (EU's Web Site, 2001, p.59). However, as more intermediaries are involved in this process, securities transactions become more complicated and linked to the international settlement and payment systems and mechanisms. As a result, a close co-operation among the stock exchanges and clearing systems becomes a necessity and mergers or alliances are formed for that purpose.

Stock exchange alliances are associations, federations or unions of stock exchange markets formed with the main purpose of promoting business through co-operation, harmonisation, and integration. Contemporary stock exchange alliances range from loose representative bodies to fully integrated ones. Between these two extremes lies a series of other combinations with varying degrees of cohesion and rigour. Often the names these institutions carry–viz., Association, Federation, and Union–are indicative of the strength of their institutional relationship.

These differences are mostly a reflection of the differences between the allying markets and the countries in which they are based. It is generally the case that where the markets and countries in which they are based are highly integrated or prone to integration, their market alliances are also more integrated.

In the next section, we give in detail some recent examples of the different forms of stock exchange alliances. The detailed account of the most important existing exchange alliances is to serve as a model for the Islamic Stock Exchange Federation or Union.

3. STOCK EXCHANGE ALLIANCES

The need for international co-operation among stock exchanges was first felt in the 1930s. The International Chamber of Commerce, based in Paris, took the initiative to create an International Bureau of Stock Exchanges, which existed until World War II. After the War, it was not until 1957 that the first major steps towards international co-operation between exchanges took place, and in May of that year, representatives of several European bourses met in Paris. Four years of informal co-operation followed, after which the participants chose to institutionalise this work in the form of a federation. The International Federation of Stock Exchanges was established in London in 1961.

International Federation of Stock Exchanges (FIBV)[3]

Since its establishment in 1961, the FIBV has grown constantly. Today, its membership encompasses 56 regulated exchanges from all over the world. FIBV members together account for over 97% of world stock market capitalisation, and most of its exchange-traded futures, options, listed investment funds, and bonds. There are also 9 more affiliate exchanges and 35 correspondent bourses.

Purpose and goals

La Fédération Internationale des Bourses des Valeurs (FIBV) is the trade organisation for regulated securities and derivative markets and related clearing houses worldwide. The FIBV is an international organisation comprised of the world's leading exchanges that are committed to the highest levels of market quality.

It provides a forum for communication, analysis and debate among members. Its purpose is to facilitate the representation and development of organised and regulated markets, and to meet the needs of evolving capital markets in the best interest of their users. Since its foundation, the FIBV has regularly held committee meetings, general assemblies, and conferences. In recent years, it has also organised specialised workshops for its members to transfer know-how and to share expertise. It discusses virtually every aspect of the securities business, be it technical, commercial, legal or economic. Over the past four decades, studies have been published on such issues as self-regulation, enforcement, trading halts, securities business conduct, and others.

The label "Member of FIBV" identifies each market as having prescribed business standards, recognised as such by members, owners, and users of exchanges, as well as by regulators and supervisory bodies. Organised and regulated financial markets do the best economic job of allocating capital on the largest possible scale. From capturing orders to trade or providing access for new company capital offerings and then carrying on through trading, reporting, settlement, and custody, FIBV member markets have developed sound business practices offering investor protection and efficient price discovery. New technologies and

[3] www.fibv.com

competition stimulate FIBV members to make their services more efficient, cost-effective, user-friendly and reliable. Sharing of business experience and knowledge among FIBV member exchanges is critical to the development of the industry, even as financial market operators offer services in an increasingly competitive environment.

The FIBV is a central reference point for the securities industry, and for exchanges themselves, the market of choice. It offers member exchanges guidance in their business strategies and in the improvement and harmonisation of their management practices. The FIBV also works with public authorities and helps promote increased use of markets. The FIBV's main goals are:

- To demonstrate the role, functioning and integrity of regulated markets;

- To maintain a platform for securities markets professionals to discuss issues of common interest, identify new approaches and solutions which enhance the competitive position of regulated markets, and develop programmes which support stock exchange operations, including research papers, workshops, benchmarking, and best practices;

- To establish harmonised standards for business processes in trading securities, including cross-border trading;

- To deepen the co-operative relationship with supervisory authorities in order to advocate the benefits of stock exchange front-line self-regulation within the total regulatory framework; and

- To support emerging exchanges in their efforts to develop markets which function according to FIBV member standards, thus contributing to global respect for the business practices of a well-run industry.

To achieve these goals, in addition to the activities mentioned earlier, the FIBV publishes a monthly newsletter, statistics bulletins and other publications on member exchanges. It also maintains statistical and information databases to keep historical records on members.

Federation of European Securities Exchanges (FESE) [4]

Europe constitutes one of the most stable regions of the world. The European countries are amongst the wealthiest and economically most vibrant. The attractions of Europe for capital seeking profitable employment remain potent. High savings rates ensure that Europe remains at the same time a significant source of capital for other parts of the world.

The Federation of European Securities Exchanges (FESE), formerly called the Federation of European Stock Exchanges, is the Brussels-based Association of Europe's Investment Services Directive (ISD) authorised stock exchanges, futures and options markets and clearing organisations. The Federation represents the voice of Europe's regulated and supervised market operators towards the authorities, especially at the EU level. The Federation's membership is open to all regulated and supervised market organisations in the EU, Norway, Iceland, and Switzerland as well as in the countries seeking accession to the European Union. The Federation is, therefore, also open to new market organisations that are subject to EU financial securities market legislation.

The Federation represents 27 stock exchanges across Europe. Additionally, 6 stock exchanges are its associate members and 4 are correspondents. The term 'correspondent' stock exchanges applies to leading market operators that are either not ready to apply for associate membership or are from countries not yet in formal negotiations to join the EU (FESE's Web Site). It is a loose federation of stock exchanges.

The new FESE represents a leap forward over its predecessor, the Federation of European Stock Exchanges, as it includes also Futures and Option Markets and Clearing Houses. This new format of the FESE may be the most suitable model for the proposed Islamic federation to follow. However, it is at a rather advanced stage, which may require a great deal of co-operation and harmonisation. It took Europe the best of the last two decades to reach this stage, and there is still some way ahead before Europe reaches its intended level of co-operation in this field. Accordingly, it may be advisable for the proposed Islamic Union to follow a phased process similar to that of Europe, starting first with a loose federation of Islamic stock exchanges.

---

[4] Formerly known as Federation of European Stock Exchanges; see www.fese.be and www.fese.org.

Purpose and goals

The Federation exists to reflect and represent the common interests of European exchanges as regulated securities markets. Its objective, broadly stated, is to contribute in the field of securities and financial markets to the attainment of the aims of the Treaty of Rome. It seeks to promote the development of securities markets in Europe by co-operating in the areas of trading, clearing, settlement and deposit of securities, and in regulatory matters. The Federation co-operates with other international organisations, in particular with the institutions of the European Union, and acts as a representative voice of its member exchanges in matters of concern to the European securities industry. In so doing, the Federation furthers the gradual process of integration of the European capital markets.

The Federation serves first as a forum in which exchanges discuss the needs of market users and look for agreement as to how those needs are to be met. The statutes of the Federation envisage not simply debate, but also joint action to create the infrastructures needed for efficient markets in Europe. In these discussions and activities, all member exchanges contribute to finding common solutions.

A continuing role for the Federation is to be a representative voice of the member exchanges in relation to the European Union institutions—principally the European Commission. Moreover, the Federation promotes a number of projects designed to further the effectiveness of the equity markets in Europe. These include:

- *The implementation of the EU Investment Services Directive*
  This directive, which confers the “European passport” on properly authorised investment firms, brings about major changes in national securities regulation. The exchanges will be an important part of the regulatory machinery after the directive is implemented, and through the Federation, the exchanges are studying the ways in which they can contribute to its effective and consistent implementation.

- *Linkages between exchanges*
  The member exchanges have agreed that the process of integration should be taken forward through bilateral and regional linkages facilitating and enhancing cross-border trading. The Federation provides the forum in which strategies and methodologies can be discussed and agreed.

- *Assistance to emerging markets*
  The newly founded market institutions in the countries of central and Eastern Europe are urgently in need of assistance—technical, legal and professional. The Federation plays a vital role in co-ordinating the provision of such assistance.

- *Economic studies*
  The Federation publishes a monthly review of statistics of stock exchange activity in its member exchanges, which forms the starting point for those who follow European trends. The Federation has taken the lead in forming an institute, the European Capital Markets Institute, which undertakes extensive studies on the efficiency of the capital markets of Europe.

In the past decade, the European stock exchanges have undergone a process of transformation. Most have been "deregulated", i.e., freed of the restraints and conditions that were normal for a largely national domestic role. Exchange membership is available to foreign-owned intermediaries, and many securities are multi-listed.

Building on their traditional strengths, the European exchanges now provide markets which function throughout the day, whereas trading used to take place only during a short session or at a single fixing. They also provide order routing for swiftness and sureness of execution at low transaction cost. They provide transparency—but enhanced by the technical possibilities now available. Exchanges have been amongst the most creative users of information technology.

The exchanges have adapted their regulations and dealing procedures to improve the liquidity in their markets. Techniques including market making and block trading and the introduction of inter-dealer brokers have all served to meet the demands for liquidity brought by the institutions. At the same time, the pricing of securities is made on a fair and transparent basis.

The explosion of cross-border trading and investment has brought additional risks into the markets. The exchanges have had, therefore, to refine the handling of orders and the execution of business so that settlement periods are reduced in length and safety of trading and settlement becomes common practice.

Then, recognising their prime role in the provision of capital for industry, many exchanges have paid special attention to the needs of growing enterprises in setting up special market sectors designed to suit the needs of smaller companies.

In a press release[5], the FESE:

- Calls for a thorough review of the Investment Services Directive (ISD) and proposes a functional approach for the regulation of markets operators. Europe’s exchanges demand a level playing field for all market operators.

- Recommends strongly the installation of a Securities Committee and a Regulatory Committee under the ISD and argues that such committees can only be successful when market experts and industry are closely involved in consultation procedures.

- Demands again the opening of US markets for the activities of European securities markets and presses for the immediate opening of a dialogue with US authorities.

- Finds that the organisation of clearing, settlement and depository service provision is not an area for top-down imposition of a structure; these areas should be left to the interplay of market forces.

Priority is given by FESE to a thorough review of the Investment Services Directive (ISD), the “Constitution” of securities legislation in Europe. Functional regulation of market operators, a level playing field for all types of market operators, and effective implementation of the single passport principle for investment firms, issuers, and markets are needed for Europe's financial markets to remain competitive. FESE would see merit in a split-up of the heterogeneous ISD into an investment-firm-related directive and a markets-related one.

Europe’s exchanges stand ready to support further efforts to streamline cross-border clearing and settlement in Europe. This area, however, is not seen as one where structure should be imposed by regulators. The interplay of market forces should be allowed to lead to solutions beneficial for investors, intermediaries, and issuers.

[5] Brussels, 22nd January 2001.

Federation of Euro-Asian Stock Exchanges (FEAS) [6]

The Federation of Euro-Asian Stock Exchanges (FEAS) was established in 1995 on the initiative of the Istanbul Stock Exchange. The headquarters of the Federation is in Istanbul, Turkey. All twelve founding members are exchanges of emerging markets in Europe and Asia, at different stages of development. Membership is open to exchanges located in Europe and Asia, subject to approval by the General Assembly. Currently, there are 22 member exchanges representing more than 9,000 traded companies and a market capitalisation of over 130 billion US dollars on an average daily traded value of over 500 million US dollars. Fifty percent of current FEAS membership is from OIC Member States.

The mission of FEAS is to create a fair, efficient and transparent market environment, with little or no barriers to trade between its members and their operating regions. For this purpose, it aims to further the co-operation and communication among its members in such areas as standardisation and harmonisation of rules and regulations, trading systems and settlement procedures, listing criteria, and adopting internationally accepted accounting principles. Its objectives are as follows:

- To encourage co-operation among the member stock exchanges in order to promote the development of securities markets;

- To act as a representative voice of the Members *vis-à-vis* the Federation and Associations of Stock Exchanges in the world;

- To promote the development of more integrated International Stock Exchanges in the region and offer listing and trading opportunities for Securities issued in the region.

The harmonisation of rules and regulations and the adoption of new technologies for trading and settlement by member securities markets are also expected to contribute towards its objectives by promoting the development of the member markets and providing cross listing and trading opportunities for securities issued within its member countries.

[6] www.feas.com.

South Asian Federation of Exchanges (SAFE) [7]

The SAFE was launched in January 2000 in Chittagong by South Asian stock exchanges from Sri Lanka, Pakistan, Nepal, India, Bhutan and Bangladesh. All securities exchanges in the South Asian region may be eligible for membership. The preamble of the Chittagong Declaration states: “Globalisation has increased the interdependence among nations and simultaneously regional co-operation forums have emerged or are emerging. Therefore, stock exchanges around the world are co-ordinating their various initiatives and forming regional federations on the regional co-operation philosophy. The immediate objectives of such federations are to enhance communication and to standardise operation procedures. Long-term objectives may include cross-border listing”. The Federation is to work on a charter stating its objectives, scope of work, organisational structure and features, and procedure of decision making.

Main objectives of the SAFE are:

- To encourage co-operation among the members in order to promote the development of their respective securities market;
- To work towards common standards, best business practices in members’ securities markets and effective surveillance of international securities transactions;
- To represent the members in related international forums;
- To encourage cross-border listing and trade in the region;
- To co-operate in human resource development and the transfer of technology;
- To provide investment opportunities for all groups of people;
- To develop a strong platform for entrepreneurs for raising capital;
- To develop a transparent market ensuring investors’ interest;

[7] www.safe-asia.org.

- To provide a fully automated trading system to ensure quick, easy and accurate transactions.

The Federation also provides services to its members in the fields of information, research, and technical co-operation. Since information on business and markets is very important for any cross-border operation, the Federation gathers data from the members and processes them into a standardised format so that they are comparable to a desired level. It disseminates them routinely among the members. The Federation acts as a catalyst for the introduction of standardised procedures and for the expansion of the markets. It provides expert advice to the member exchanges in their own and integrated development in light of international modern practices. Furthermore, it also organises conferences and seminars on relevant topics relating to the regional and world markets and arranges executive exchange programmes.

African Stock Exchanges Association (ASEA)

The African Stock Exchanges Association was incorporated in 1993 in Kenya. Its main aim is to provide a formal framework for the mutual co-operation of stock exchanges in Africa through various processes encompassing the exchange of information and assistance in the development of member exchanges. ASEA has the following objectives[8]:

- To provide a formal framework for the mutual co-operation of stock exchanges in Africa through various processes encompassing the exchange of information and assistance in the development of member exchanges;

- To assist members in establishment of stock exchanges, development of financial instruments and promotion of stockbrokers and dealers;

- To develop and establish standards of training and professionalism amongst stockbrokers and dealers, and personnel associated with members;

- To develop and establish standards of listings, maintenance of listings, issuing trading and settlement of securities;

[8] Information for Africa (Mbendi), www.mbendi.co.za/orgs/cdkp.htm.

- To assist members in the development of self-regulation to the greatest possible extent and assist members in representations to the national and international bodies in this regard;

- To assist members in the promotion and development of services associated with the capital markets;

- To promote and develop the establishment of a data bank and information system for the mutual benefit of members; and

- To study research and investigate matters of interest to members.

Southern African Development Community (SADC) Exchanges' Committee

The SADC Committee of Stock Exchanges was formed in January 1997 as a private sector initiative within the SADC framework. Its Membership is open to all the member countries of the SADC. Member countries with established exchanges include Botswana, Malawi, Mauritius, Mozambique, Namibia, Swaziland, South Africa, Tanzania, Zambia and Zimbabwe.

Main objectives are:

- To maintain and improve market integrity in order to have markets that are fair, efficient and transparent with proper price discovery;

- To increase liquidity of trading in equities, bonds, derivatives and other financial instruments;

- To enforce legislation and rules and protect market participants and investors;

- To make the SADC securities markets more attractive to local and international investors;

- To raise capital for the regional economic development;

- To improve the operational capacity of SADC stock exchanges;

- To advocate and lobby for private-sector-led regional market integration;

- To build co-operation between SADC stock exchanges and their regulators;

- To establish a forum through which SADC region policy makers can consult the region's existing securities markets before planning further developments within this field.

To this end, the Committee advocates the policies and strategies, which build upon the concepts of harmonisation and rationalisation of operations to be applied where appropriate. Accordingly, the exchange of information, expertise and experience will form a significant part of the process.

Federacion Iberoamericana de Bolsas de Valeores (FIABV)

The FIABV was created in Rio de Janeiro, Brazil on 27 September 1973. Member countries with regulated stock exchanges include Argentine, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Spain, Mexico, Peru, Portugal and Uruguay.

Its main objectives are as follows:

- To foster co-operation among its members, in order to promote the development and advancement of their securities markets, in the best interest of all market participants;

- To co-operate with national and international entities having legislative, regulatory, or other functions in respect of financial and securities markets with a view to ensuring homogeneous standards and regulations as to handling securities operations, trading, issuers, brokers, securities markets, securities depositories and custodians;

- To promote integration of the Federation's stock markets, stimulating inter-activity of market participants as well as the free circulation, within their respective jurisdictions, of securities issued in any of its Members' home country; and

- To encourage the establishment of rules and procedures ensuring solvency, competence, legitimacy, and fair information disclosure to all savers investing through Member Exchanges.

EURONEXT[9]

The Euronext stock market, which is the first European stock exchange, was created in September 2000 by the merger of Amsterdam and Brussels Exchanges and the Paris Bourse. Euronext is the driving force behind the consolidation process in the European capital markets and builds on the strength of the Amsterdam, Brussels and Paris Exchanges. It was created in response to a growing demand from the market—favourable climate to achieve further consolidation in the European capital market—and to meet the need for greater liquidity and lower costs resulting from the introduction of the euro.

It has the biggest market capitalisation in Euroland (51% of the total), the biggest commodities exchange in Europe and is the number one exchange for options. It is also a truly international merger with transnational business units, transnational management, and transnational shareholders and members.

Euronext is not only a merged entity, it is also an open venture. It conducts its business through three separate operators: Euronext Amsterdam, Euronext Brussels and Euronext Paris. These three operators and their regulated markets are subject to local requirements governing official stock exchange status.

The Euronext intends to promote capital markets in Europe and to set global standards for financial markets in the fields of information, trading, clearing, and settlement services. It also intends to form alliances for the benefit of an efficient and enlarged European capital market. Furthermore, it aims to deliver quality and competitive services to clients, intermediaries, investors and issuers. In this regard, the Euronext has replaced floor trading with screen trading, and built a fully-integrated exchange encompassing listing, trading, netting, clearing and settlement. Following the footsteps of its constituting three predecessors, the Euronext is a member of the Federation of European Securities Exchanges (FESE).

---

[9] www.euronext.com.

NOREX

The NOREX is a strategic alliance between Nordic stock exchanges with the aim of offering investors, issuers and members a cost-effective and high quality Nordic securities market. It covers a wide range of investment opportunities. The alliance is based on the principles of cross membership, a common trading system and a common regulatory framework.

To that effect, member stock exchanges of NOREX have created the possibilities for efficient cross-border trading, but a common system for settlement is still missing. Nonetheless, market's demand for a single system for clearing and settlement are to be met through an integrated approach. The alliance also aims to harmonise rules, regulations and requirements among the stock exchanges with respect to trading and membership.

4. MODELS OF MUTUAL TRADING AMONG SECURITIES MARKETS

Cross Listing

Cross Listing is the admission for listing/trading of securities, which are already listed on a local stock exchange, on foreign stock exchanges. Cross-listed securities will be subject to the rules and regulations of the local exchanges. Although cross listing is subject to the preference of the companies, stock exchanges may facilitate cross listing by opening their markets to the securities listed in other exchanges on a correspondence basis.

Cross Membership

Cross membership is accepting the members of other stock exchanges for membership. Cross membership is a means for the intermediary institutions to access foreign stock exchanges directly. There are two alternative systems to be pursued for cross membership. One of them is remote membership and the other is buying or selling through a brokerage house in the country where the trading takes place.

For a remote membership, Central Securities Depository (CSD) opens both cash and securities accounts for remote members or for their home country's CSD in the settlement systems of the host country that the trading takes place (See Table 1). Moreover, cash correspondent relationship can be established in case of necessity. On the other hand, a uniform and standard custody agreement for this purpose is suggested to be adopted in order to ease the problems that might occur as a result of different market practices. Essentially, settlement members are foreign brokers or their home country's CSD. Settlement of securities and payment is realised by CSD of the country where the trading takes place.

TABLE 1: TRADING UNDER CROSS MEMBERSHIP

A) Remote Membership	CSD opens both cash and securities accounts for remote members or for their home country's CSD in the settlement system of the country where the trading takes place.
Settlement members	Foreign brokers or their home country's CSD.
Settlement of securities and cash	It is realised by the CSD of the country where the trading takes place.
B) Buying or selling through a brokerage house in the country where the trading takes place	Foreign brokers can directly trade through a local broker in the country.
Settlement members	Local brokers.
Settlement of securities and cash	It is realised by the CSD of the country where the trading takes place.

Source: Derived from http://www.unece.org.

On the other hand, in case of buying or selling through a brokerage house in the country where the trading takes place, foreign brokers directly trade through a local broker in the country (See Table 1). Although the local broker is a direct party to the settlement, in case of default, foreign brokers or their stock exchange or settlement institution are accepted as responsible for the fulfilment of due obligations. For this purpose, an agreement is signed between local and foreign brokers together with both brokers' stock exchanges and settlement institutions. Essentially, settlement members are local brokers. Settlement of securities and cash is realised by CSDs of the country where the trading takes place.

Common Trading Platform (CTP)

The Common Trading Platform (CTP) is a central trading platform that will be created in order to enable the securities of the companies in member country jurisdictions to be traded collectively in accordance with the principles established by the participating stock exchanges. These principles consist of special rules that make up the legal, organisational and technical infrastructure of the trading platform. There are two alternative approaches used for it.

In the first approach, a CTP provides a Centralised System, where CTP is administered by an Executive Committee consisting of the representatives of the participating stock exchanges and operated by a CTP operator. In this case, the CTP operator will be located in one of the participating countries and will be a legal entity or a stock exchange within the jurisdiction of a member country. However, by pursuing this model, the existing systems for the local markets will be preserved while the participating stock exchanges will jointly design a new trading system to be used for the CTP.

On the other hand, the other approach used is a CTP providing an Order Routing System without having to establish a Centralised System. In this model, a new trading system will be adopted by the participating stock exchanges or a common interface will be installed among them. Thus, the CTP may be jointly operated by all the participating stock exchanges and will be a legal entity.

Moreover, regardless of whether it is a centralised or decentralised model, settlement members in case of a CTP are brokers and local custodians or Central Securities Depositories (CSDs) of member countries. However, this may create risks as a result of a lot of institutions getting involved in these transactions. On the other hand, local rules and regulations in some countries may not allow a CSD to become a member to such systems. In addition, the settlement risks of brokerage houses can also create problems for the CSDs.

5. PROPOSED MODEL FOR OIC STOCK EXCHANGE ALLIANCE

Current Situation

As in the experiences discussed above, the proposed model for the OIC exchange alliances will essentially depend on the state of development in the main OIC markets. A rough picture in this regard is reflected in this paper's Statistical Annex. The four tables in the annex reflect the OIC stock exchanges' state of development vis-à-vis Developing, Emerging and Developed Markets. The criteria used by the International Finance Corporation (IFC) in these comparisons are levels of capitalisation (Table 1), value traded (Table 2), and number of listed companies (Table 3). According to these three criteria, Table 4 shows the OIC markets that appear in the top forty markets in the world.

Lessons and Insight

From the various existing models discussed previously, the following insights and lessons can be inferred:

- The proposed OIC alliance may be a full merger or union such as Euronext, a tight federation modelled on FESE or a rather looser federation such as FEAS or SAFE. A third option for the proposed alliance is to create a platform such as the FIBV, which serves only as representative and meeting body with some common resources and services that are shared between members.

- The full merger scenario requires high integrability, analogous levels of development and firm and strict conditions. Hence, it is not practical at the beginning for OIC-wide co-operation, but is plausible and probably best for smaller regional or sub-regional OIC groups such as the Gulf Cooperation Council (GCC).

- The remaining two models are plausible, and would serve as models for OIC co-operation in this area. In either case, the alliance could be open only to authorised stock exchanges in the OIC world, but later, may include also futures and options markets and clearing organisations.

- Taking a gradual approach, 'the exchanges only' could serve as an initial proposal while the inclusion of futures and options markets and clearing organisations could be regarded as scope for development, as the member exchanges and securities markets mature through time.

- The tight alliance option may be the best to serve the purposes of more integrated co-operation schemes. This scenario requires a close-knit crew and a considerable degree of homogeneity and harmonisation among economic policies of the members. While this scenario may be difficult to achieve at first, it is nevertheless plausible and will be adopted as a final target-model for the OIC co-operation in this area.

- Accordingly, this paper recommends the OIC co-operation in this area to start as a relatively loose federation under the name, 'The Federation of Islamic Stock Exchanges' (FISE). This loose federation is to be limited to an initial predetermined period; we propose 3-5 years after which the federation is to gradually become increasingly encompassing and binding and achieve its final envisaged shape no later than its 10th anniversary.

- In its final format, the FISE is to include all Islamic financial institutions that are engaged in issuing, trading, listing, clearing and transferring of securities.

- The proposed federation is to have a charter spelling out its objectives, organisation, and operational rules. It should also clearly state the time frameworks for the projected development of the FISE.

- Alternatively, OIC co-operation in this area may take the form of a common platform and meeting place with a limited range of common resources and services.

Proposed Federation's Goals and Objectives

The main objective of the FISE will be to mobilise financial resources within the Islamic world and to enable Islamic firms and corporations to raise essential resources within that domain. For these objectives to materialise, the FISE will help create a proper setting for savers and investors to meet. A proper environment means building of the essential confidence and trust among savers and security and guarantees for investors.

In line with existing experiences, the proposed FISE may serve the following purposes:

- To serve as a forum for communication, debate and analysis for OIC capital markets;

- To promote and develop capital markets in the OIC countries;
- To facilitate foreign investment in the OIC capital markets;
- To help OIC countries develop organised and regulated securities markets and promote high standards of regulation and efficient markets;
- To harmonise business standards to facilitate cross-border/market trading of securities;
- To support emerging OIC exchanges to develop their markets on internationally recognised standards by offering know-how, expertise and facilities;
- To create the processes and plans which bring members' markets closer in terms of their rules, procedures and standards, thus increasing their integrability and helping thereby their gradual integration;
- To further the Islamic Common Market objective by integrating members' capital markets;
- To carry out market studies and keep statistics records on member exchanges;
- To assist the privatisation and deregulation process of member exchanges to free them from existing restraints and conditions which are designed for a national domestic role;
- To help members disseminate information about their markets through the Federation;
- To represent the common interests of members in international bodies such as the FIBV and the International Organisation of Securities Commissions (IOSCO).

Proposed Steps to Launch the OIC Exchanges' Federation

Step 1. Initial Authorisation

The proposed FISE project can be put before the OIC policy bodies for an initial resolution endorsing the project in principle and forming an ad-hoc committee on the matter. The ad-hoc committee would be composed of senior experts and representatives from the participating stock exchanges, clearing houses and other relevant institutions in the OIC countries and should study the project and write a detailed and comprehensive report on how to go about it. The report may be discussed within COMCEC before it is put before higher OIC fora for final authorisation.

Step 2. Committee Stage

As proposed earlier, this committee is to fully study the project, discuss and decide on the level of integration of the proposed 'Federation' or 'Union' and write a detailed and comprehensive report covering its legal, institutional, financial and operational aspects. The report should also include a clear and detailed development plan of the project, taking into account the proposals put forward by this report and any comments and proposals that may arise during the initial stage.

The Committee, in addition to the officials who will lead and present the issue, must include the managers or representatives of established OIC stock exchanges and other relevant institutions. It should also include renowned experts in the various areas related to the project, which include the following:

1. Legal side: This includes the legal framework of the federation and the form of its agreement, a code of conduct, and a charter or a constitution, etc. It also includes the rules and regulations that govern the operational aspects of the project, the procedures and entitlements of membership.

2. Institutional side: This has to do with the type of institution that is most suitable for OIC purposes. The main question to answer in this respect is what form the OIC alliance should take and, accordingly, what its name should be.

3. Operational aspects: This deals with the practicalities of the project. It involves the drawing up of a plan including a time frame and the financial requirements of the proposed project.

4. Procedural and organisational aspects: This relates to the internal organisation of the proposed institution and the system through which it is to be managed.

Step 3. Final Authorisation Stage

This stage includes the steps to be taken after the Committee Stage and until the issuance of the final resolution of the project. It includes consultations at the levels of the OIC and of its institutions on the Committee's report and recommendations. These, together with the results of the consultation process, are to be put before the higher OIC bodies for the final decision on the implementation of the project.

6. CONCLUDING REMARKS

The Islamic Stock Exchange and Clearing Union is an important project which is vital for OIC economic co-operation, in general, and for enhancing investment opportunities in the OIC countries, in particular. Through this project, existing stock exchanges, clearing houses and related financial institutions will co-ordinate and standardise their policies, rules, regulations and procedures in an effort to bring them in line with those of the rest of the world. Standardisation and harmonisation will help regulated OIC exchanges and capital markets to integrate and thus become a recognisable group and a force to reckon with in the international financial markets.

There is a two-way relationship between the vigour of any alliance and the strength of relationship and integrability of its members. Thus, the more integrated and integrable the OIC stock exchanges and other related institutions and markets are, the more vigorous their proposed alliance will be, and vice versa.

This paper suggests a step-by-step approach for the establishment of the proposed alliance among the OIC exchanges and clearing houses, starting with a loose federation and moving progressively and gradually towards a more integrated form of alliance. For this purpose, an *ad hoc* committee composed of senior experts and representatives from the OIC stock exchanges and clearing houses will be formed because the subject is highly technical and needs specialised knowledge and experience. The Committee will be mandated to study the project, discuss its level of integrity, and determine the phases of its implementation procedures within a time frame. The Committee should report in detail on these issues to the COMCEC before the project is put before higher OIC fora for final authorisation.

REFERENCES

Ariman P. (2002), Introduction to FESE's 6th Annual Convention, FESE General Secretary, Brussels, http://www.fese.be/efmc/2002/introduction.htm.

Bank for International Settlements (BIS) (2001), Recommendations for Securities Settlement Systems, Bank for International Settlements (BIS), Basel, November 2001.

Euroclear System, Euroclear Operations Centre, Morgan Guaranty Trust Company of New York, Brussels, Belgium.

Euronext Web Site, http://www.euronext.com.

European Union (EU) Web Site (2001), Cross-Border Clearing and Settlement Arrangements in the EU, http://www.europa.eu.int/comm/economy-finance/publications/giovannini/1101_en.pdf.

Federation of European and Asian Stock Exchanges (FEAS) Web Site, http://www.feas.com.

Federation of European Stock Exchanges (FESE) Web Site, http://www.fese.be.

Federacion Iberoamericana de Bolsas de Valores (FIABV) Web Site, http://www.fiabv.org.

Fuller T. (2002), Forging a 'constitution' for Europe, International Herald Tribune, Frankfurt, February 27, 2002, p.1 and p.4.

Glenn G. Munn, Revised by Garcia, F. L. 1984, *Encyclopaedia of Banking and Finance*, 8th Edition, Bankers Publishing Company, Boston, pp.892-3.

Information for Africa (Mbendi) Web Site, http://www.mbendi.co.za/orgs/cdkp.htm.

International Federation of Stock Exchanges (FIBV) Web Site, http://www.world-exchanges.org.

International Finance Corporation (IFC) (1999), *Emerging Stock Markets Factbook*, International Finance Corporation, 2121 Pennsylvania Avenue, NW, Washington, D.C. 20433 USA.

International Finance Corporation (IFC) (2001), Emerging Stock Markets Factbook 2001, International financial Corporation, 21221 Pennsylvania Avenue, NW, Washington, DC 20433 USA.

International Monetary Fund (IMF) (2000), *International Capital Markets, Developments, Prospects and Key Policy Issues*, International Monetary Fund.

London Stock Exchange, Economic and Monetary Union (EMU), Market Information Update.

NOREX Web Site, http://www.norex.com.

Objectives and Principles of Securities Regulation (Executive Summary and parts I, II and III), IOSCO Public documents, www.iosco.org.

Peter Newman, Murray Milgate, John Eatwell (eds.), THE NEW PALGRAVE (3) 1994, *Dictionary of Money and Finance*, Macmillan 1994, pp. 563-594.

Walmsley, Julian 1979, *A Dictionary of International Finance*, The Macmillan Press Ltd., p. 234

International Federation of Stock Exchanges Web Site, www.fibv.com.

Federation of Euro Asian Stock Exchanges (FEAS) Web Site, www.feas.org.

South Asia Federation of Exchanges (SAFE) Web Site, http://www.safe-asia.org.

Southern African Development Community (SADC) Exchanges' Committee, http://www.jse.za/information/SADC/1_sadc.htm.

Standard & Poor's Web Site, www.spglobal.com.

Federation of European Securities Exchanges (FESE), Web Site www.fese.be and www.fese.org.

JSE (Johannesburg Stock Exchange) Securities Exchange South Africa, Home of the Federation of African Stock Exchanges, www.jse.co.za.

Chittagong Declaration 16th January 2000, www.safe-asia.org.

International Organisation of Securities Commissions Web Site, General Information on IOSCO, www.iosco.org.

United Nations Office in Europe's Web Site, http://www.unece.org.

STATISTICAL ANNEX

TABLE 1: OIC MARKETS CAPITALISATION, 1990-2000
(US$ millions, end of period levels)

Market	1990	1995	1996	1997	1998	1999	2000
OIC Markets							
Azerbaijan					3		
Bahrain					6770	7155	6624
Bangladesh	321	1338	4551	1537	1034	865	1186
Egypt	1765	8088	14173	20830	24381	32838	28741
Indonesia	8081	66585	91016	29105	22104	64087	26834
Iran		6552	17024	15123	14874	21858	34041
Jordan	2001	4670	4551	5446	5838	5827	4943
Kazakhstan				1342	1831	2265	1342
Lebanon		400		2904	2385	1921	1583
Malaysia	48611	222729	307179	93608	98557	145445	116935
Morocco	966	5951	8705	12177	15676	13695	10899
Nigeria	1372	2033	3560	3646	2887	2940	4237
Oman		1978	2662	7108	4392	4302	3463
Pakistan	2850	9286	10639	10966	5418	6965	6581
Palestine				705	293		
Saudi Arabia		40907	45861	59386	42563	60440	67171
Tunisia	533	3927	4263	2321	2268	2706	2828
Turkey	19065	20772	30020	61090	33646	112716	69659
Uzbekistan			128	465		119	50
IFC Index Markets	**613322**	**1901072**	**2225110**	**2142082**	**1825231**	**3112461**	**2691452**
All EM Index	**613621**	**1910685**	**2248073**	**2167329**	**1855259**	**3152068**	**2739726**
OIC Developed Markets							
Kuwait		14353	21840	26013	18131	18814	20772
UAE					33284	38211	23262
All Developed Markets	8784770	15877402	18004584	20949148	25092702	32996683	29520707
World Total	9398391	17788087	20252657	23116477	26947961	36148751	32260433

Source: IFC Emerging Stock Markets Factbook 2001, pp. 33-34.

TABLE 2: VALUE TRADED IN OIC MARKETS, 1990-2000
(US$ millions, end of period levels)

Market	1990	1995	1996	1997	1998	1999	2000
OIC Markets							
Azerbaijan							
Bahrain					577	444	247
Bangladesh	5	158	722	385	789	789	768
Egypt	91	677	2463	5859	5028	9038	11120
Indonesia	541	14403	32142	42927	10610	19903	14311
Iran		741	2617	1212	1389	2270	4998
Jordan	652	517	297	501	653	548	416
Kazakhstan				2	26	19	89
Lebanon				640	328	97	118
Malaysia	6888	76822	173568	153292	29869	48512	58500
Morocco	16	2426	432	1061	1390	2530	1094
Nigeria	4	14	72	132	161	145	263
Oman		211	545	3880	1943	529	553
Pakistan	193	3210	6054	11369	9038	21057	32974
Palestine				25	69	150	199
Saudi Arabia		6194	6773	16549	13712	14816	17313
Tunisia	32	663	281	260	186	420	626
Turkey	798	51392	36831	59105	68464	81277	179269
Uzbekistan			70	43		37	19
IFC Index Markets	**1169219**	**1045449**	**1570134**	**2372455**	**2413231**	**3197785**	**4946177**
All EM Index	**1169219**	**1046287**	**1572939**	**2374347**	**2415194**	**3111091**	**40511905**
OIC Developed Markets							
Kuwait	1709	6389	19203	34576	9333	6061	4210
UAE							118
All Developed Markets	6298778	9180430	12028406	16117476	20169289	27249345	43817893
World Total	7467997	10226717	13681353	18491831	22575479	39360435	47069186

Source: IFC Emerging Stock Markets Factbook 2001, pp. 36-37.

TABLE 3: NUMBER OF LISTED COMPANIES IN OIC MARKETS, 1990-2000 (end of period levels)

Market	1990	1995	1996	1997	1998	1999	2000
OIC Markets							
Azerbaijan					2		
Bahrain					38	41	41
Bangladesh	134	183	186	202	208	211	221
Egypt	573	746	649	654	861	1033	1076
Indonesia	125	238	253	282	287	277	290
Iran		169	220	258	275	292	304
Jordan	105	97	98	139	150	152	163
Kazakhstan					18	17	23
Lebanon		3		9	12	12	12
Malaysia	282	529	621	708	736	757	795
Morocco	71	44	47	49	53	56	63
Nigeria	131	181	183	182	186	194	196
Oman	55	80	94	114	131	140	131
Pakistan	487	764	782	781	773	765	762
Palestine				19	20	23	24
Saudi Arabia		69	70	70	74	73	75
Tunisia	13	26	30	34	38	44	44
Turkey	110	205	229	257	277	285	315
Uzbekistan			4	4		4	5
IFC Index Markets	**8995**	**16817**	**18639**	**18603**	**24795**	**24546**	**25253**
All EM Index	**9101**	**17954**	**19949**	**20075**	**26354**	**26800**	**25937**
OIC Developed Markets							
Kuwait		52	60	74	69	76	77
UAE				44		63	54
All Developed Markets	16323	18817	20138	20033	19927	22277	23996
World Total	25424	36601	39936	39127	45743	40557	49993

Source: IFC Emerging Stock Markets Factbook 2001, pp. 38-39.

TABLE 4: OIC COUNTRIES FIGURING IN TOP 40 RANKINGS

Rank According To:					
Market Capitalisation		Total Value Traded		Number of Listed Companies	
Country	Rank	Country	Rank	Country	Number
Malaysia	25	Turkey	19	Egypt	10
Turkey	29	Pakistan	30	Malaysia	15
Saudi Arabia	30	Saudi Arabia	34	Pakistan	17
Iran	37	Indonesia	37	Turkey	26
		Egypt	39	Iran	27
				Indonesia	30
				Bangladesh	40
Total	**4**	**Total**	**5**	**Total**	**7**

Source: IFC Emerging Stock Markets Factbook 2001, p. 40.