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Executive Summary

**Demutualization: Introduction,
influence and the predicted ownership
structure for the Tel Aviv Stock
Exchange**

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The Program awards annual fellowships to outstanding Israeli graduate students. We train and deploy some of Israel's best and brightest young professionals to create pragmatic financing and economic policy solutions. Our applied research and Financial Innovations Labs® are a launching pad for transformative change, using innovative financing mechanisms, programs and policies to bridge social, regional, economic and productivity gaps within Israel and between Israel and the world.

In addition, Fellows craft their own projects during their internship aimed at barriers to job creation and capital formation in Israel. The Fellows' research, carried out under the guidance of an experienced academic and professional staff, support business and policy makers to shape economic reality in Israel. The program offers the ultimate training opportunity, combining real-life work experience with applied research.

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The focus of this research is the change in the legal ownership structure of stock exchanges from a mutual or cooperative not-for profit-ownership model to a for-profit, joint-stock company. This phenomenon, referred to as demutualization, is designed to, among other things, modernize trading platforms, and has occurred on stock exchanges worldwide. The structure of ownership of stock exchanges has a major impact on many aspects of an exchanges' operation: from incentives, risk management, operational efficiency and corporate governance to technology and cooperation. This ownership change from a mutual association to what is in most cases a joint-stock company can prove to be of importance to capital market performance of the exchange. Demutualization of the Tel Aviv Stock Exchange (TASE) was the first recommendation of Ben-Chorin Commission (2013), in order to enhance the liquidity, efficiency and performance of Israel's capital market. In 2014, following the Commission, a bill calling for the demutualization of the TASE was published.

While the literature on demutualization is diverse, earlier comparative research has shown that many indicators of market performance improved oftentimes in terms of domestic market capitalization, capital raised by domestic companies, total value of share trading, turnover velocity and efficiency. Given that, this research addresses three main questions that come up in the context of the demutualization of the TASE: (1) what exactly is demutualization, and why did the phenomenon begin to appear globally during the last decade of the 20th century? (2) What can we learn from the global experience of demutualization? (3) What is the predicted ownership model for the TASE in light of Israel's local market composition?

The core element of the demutualization process is the ownership from a private mutual association to joint-stock corporate ownership. The demutualization trend started at the 90's as a result of technological, economical and regulatory developments, which created a competitive environment for capital markets. The demutualization process enabled exchanges to better compete for global portfolio flows of investment. This new ownership structure of stock exchanges incentivized investment in technological infrastructure, efficiency, cooperation, economies of scale, and the prevention of conflict of interests. All the leading stock exchanges went through demutualization process during this period. And demutualized exchanges, on average, enjoyed expanded membership and higher rates of foreign company listings.

In order to learn from the global experience of demutualization, we sent questionnaires to all the countries with stock exchanges that underwent this process. This survey enabled us to learn from firsthand about the transition to demutualized stock exchange.

The main findings are:

- Overwhelmingly, the regulatory agencies that oversaw these stock exchanges defined the demutualization process as a success. The success is measured mainly, but not only, by technology improvements and associated innovations in trading platforms.
- Usually, the variety of the services (data information, research, post-trade reporting, and marketing) provided by the exchange increased following demutualization, and the fees and commission associated with stock exchange listings and operations decreased.
- Institutional investors and foreign exchanges largely replaced the brokers and banks that previously owned the stock exchanges prior to demutualization.
- The demutualization process usually led to the adoption/development of new technologies for the trading platforms and to cooperation between exchanges (for example, mergers, derivatives trading, and database management).

To examine the joint stock company ownership model recommended for the TASE, this research strengthened the qualitative analysis described above through additional statistical models, macro data and other indicators for 66 countries between the years 2001-2013. The goal of this quantitative work was to create a predictive model that would gather all relevant variables and retroactively predict when a given stock exchange might have transitioned to from a mutual ownership to joint-stock corporate ownership. Through this analysis, predictions about the ownership structure of various stock exchanges were made quite accurately for the countries and years in the sample. However, the prediction for Israel's ownership structure reveals that, at least from 2006, the TASE possessed the necessary fundamentals to warrant a corporate, demutualized structure. These results hold under several sensitivity analyses and with robust significance, meaning that Israel is the only country not to have demutualized when it's market structure and macroeconomic conditions clearly would have predicted it.



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