

Competitive Developments at European Exchanges

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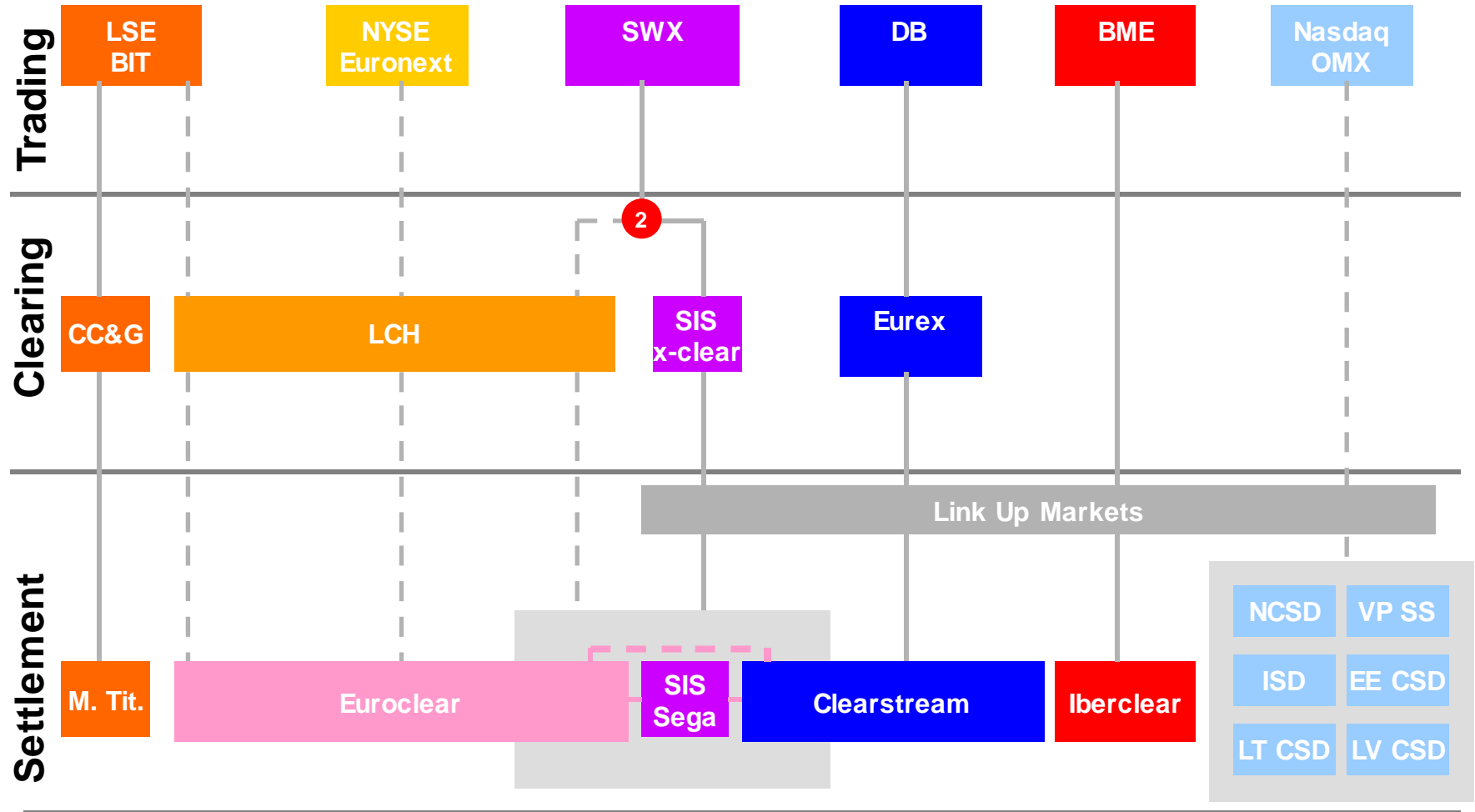
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Pre-Mifid Environnement

- Market concentration rule (shares)
- Markets organised or working in silos
- Trend towards consolidation (NYSE Euronext, OMX NASDAQ)
- Booming times for equity markets

2004 - European equity landscape before MiFID



Competition issues

(source Clifford Chance)

Barriers to Entry

- Regulation
- Scale and scope effects

Market Behaviour

- Switching
- New Entry/Innovation
- Volumes and Prices

Vertical Integration

- Service bundling
- Cost allocation (margin squeeze)
- Excess predatory pricing

Regulatory Conundrum

(source Clifford Chance)

Why EU are EU national and cross border trades more expensive than US trades?

- Scale effects?
- Scope effects?
- Network effects – liquidity?

How to promote competition without reducing liquidity and increase trading costs?

Competition findings

(source Clifford Chance)

Dominant position of incumbent exchanges

- Competition limited to certain services (e.g. LSE and NYSE competing on non domestic primary listings)
- Reported dissatisfaction surrounding fees
- Few anti trust actions

Little opposition to exchange consolidation

- Except when extension of vertical silos
- Except where merger of possible closest competitor

Obstacles to Competition

(source Clifford Chance)

Limited Competition between Exchanges

- Network effects limited competition
- Multiple exchanges created technical difficulties (no simple smart order routing)

Limited Penetration of ATS

- Concentration Rule in some Member States
- Regulatory Restrictions (trade Reporting Rules, Stamp Duty in the UK)

General statement concerning incumbent RM (exchanges)

- Complacent with very high margins
- Ivory Tower Mentality
- No will to cooperate (several projects failed)

- Not aware of technological developments
- Poor lobbyist

Competitive Developments due to Mifid

(source Clifford Chance)

Competition in trading and reporting

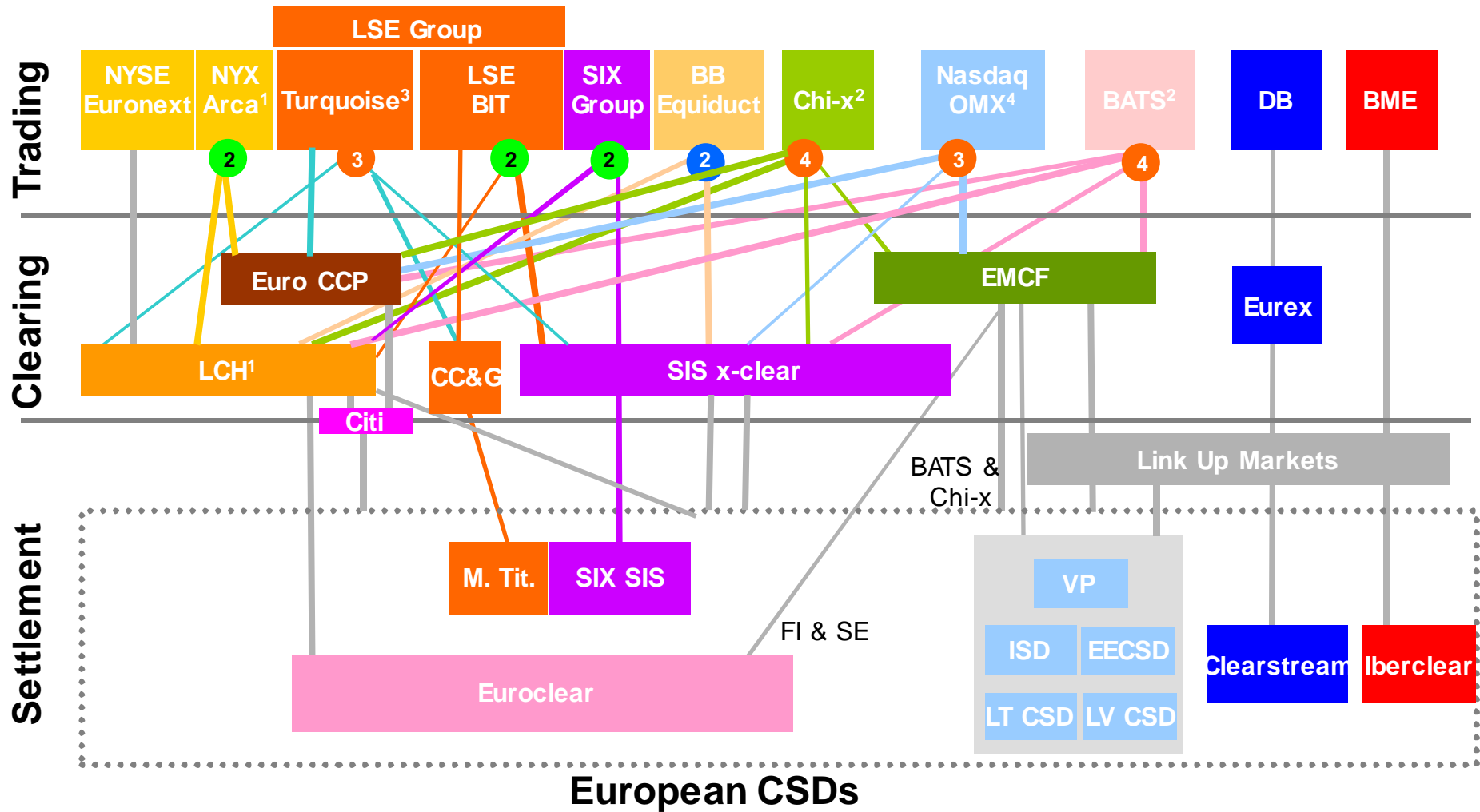
- No concentration rules
- Best execution to facilitate switching of orders
- Removal of regulatory sanctioning of monopoly in trade reporting

Does MIFID remove all obstacles ?

- Some obstacles still remain (stamp duty)

2011 - European equity markets after MiFID

Source FESE



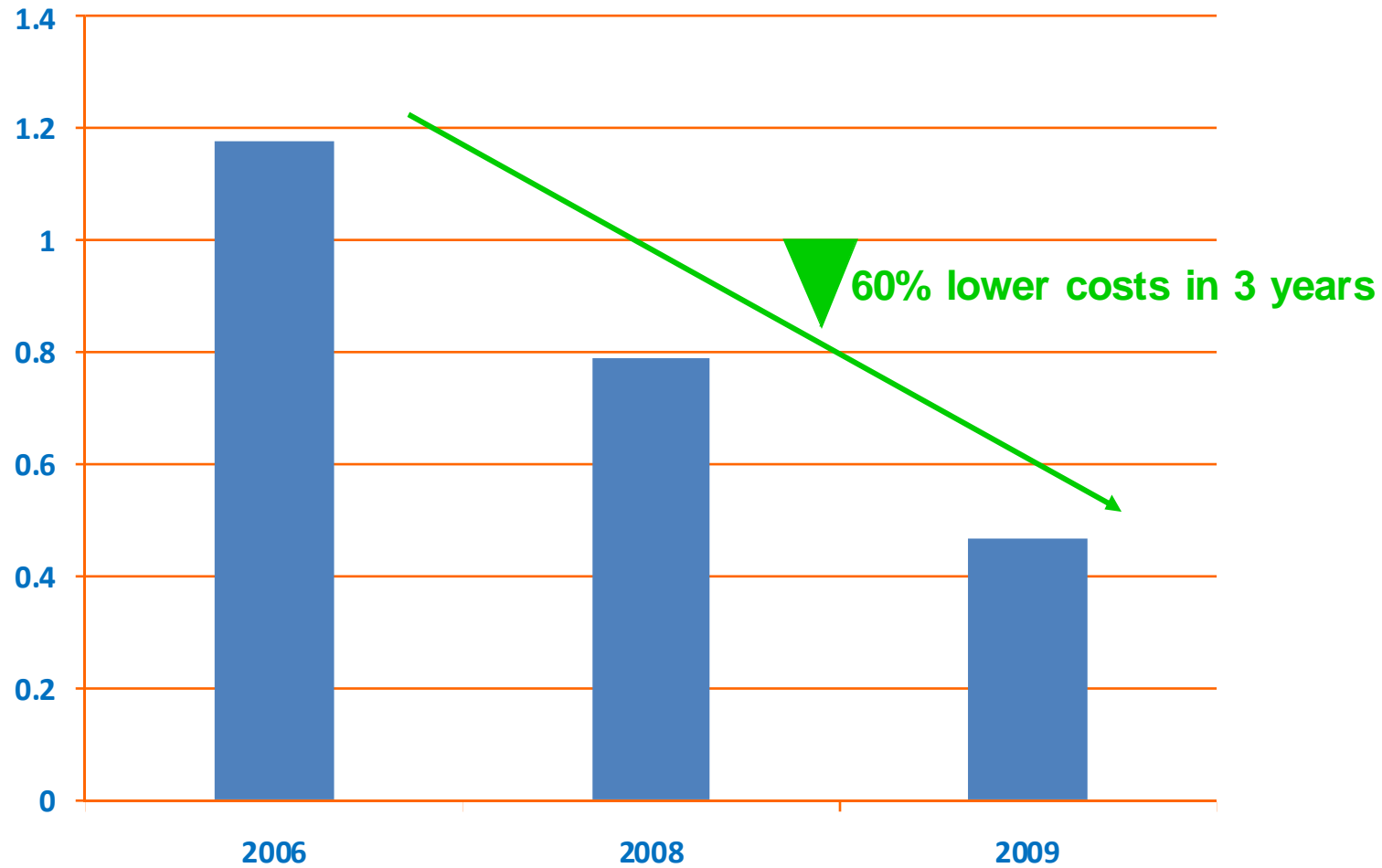
Notes to table page 11

1. In May 2009 announced competitive clearing agreements
2. In July 2011 announced intention to offer a choice of four clearers
3. In September 2011 announced intention to offer a choice of three clearers
4. In October 2011 announced intention to offer a choice of three clearers

Note: In green the interoperability agreements in place, orange those on hold due to review by the regulators or to discussions between the parties, in blue other arrangements.

Impact of MiFID on trading costs:

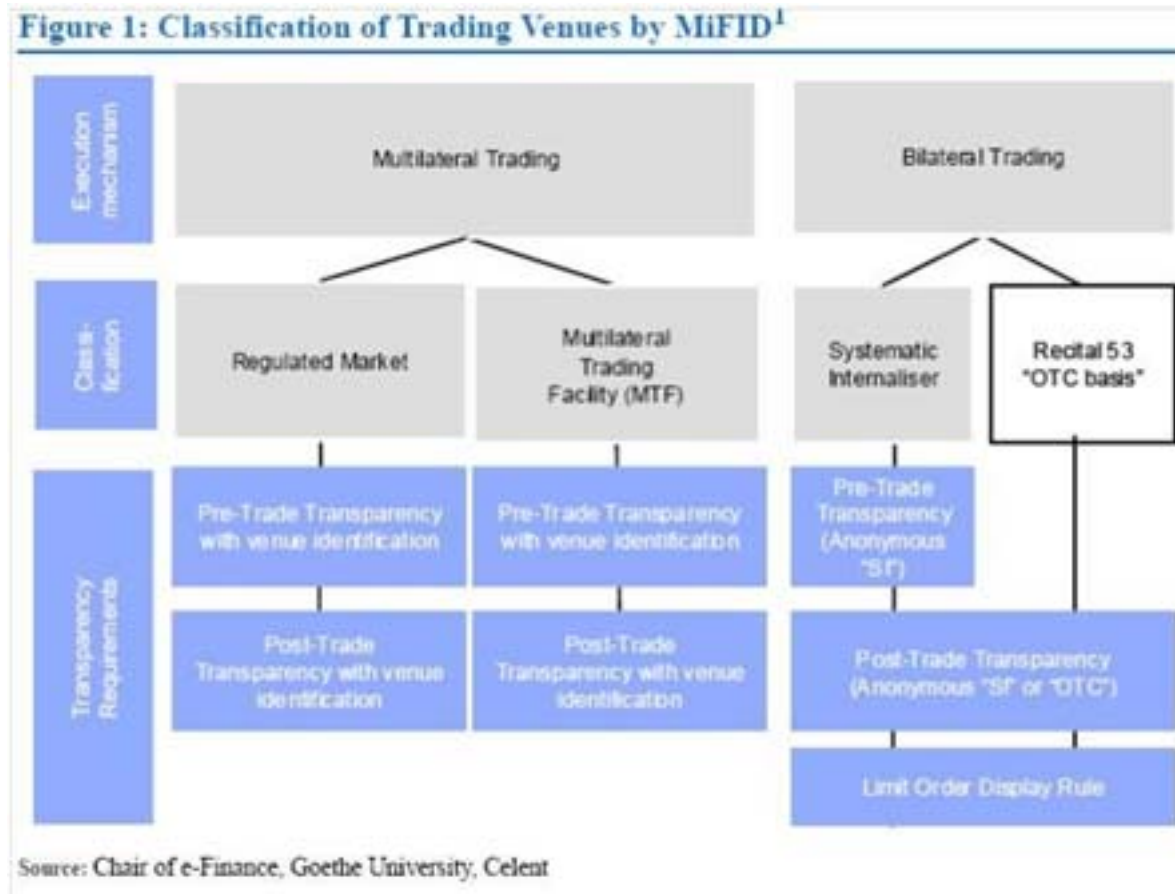
Cost per transaction (EUR) source FESE



Source: EU Commission study 'Monitoring prices, costs and volumes of trading and post-trading services', 2009 & 2011

Venues competing for order flow...

as required by MiFID I - source FESE



Effect of Mifid

Significant increase of trading outside primary exchange

- more efficient services
- more innovation (only due to MIFID?)
- Implication of HFT

Significant reduction of trading in individual trading venues

- less economies of scale
- less network externalities

Effect of Mifid

Mifid

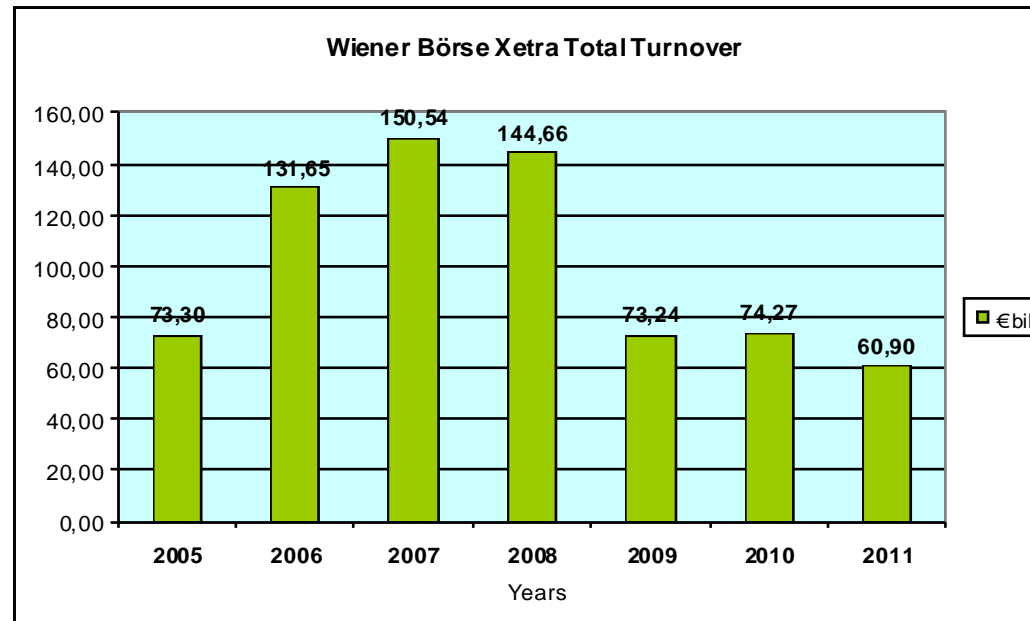
versus

Regulation National Market System (RegNMS)

discrepancies due to different ways EU and US regulate data consolidation and best execution in particular there are imperfections in the consolidation process of pre/post trade information

Example of the Vienna Stock Exchange

(source Wiener Börse AG)



Equity markets, structured products, other securities (double counting)

Consequences for medium sized RM

- Less Liquidity
- Fewer market makers
- Little attraction for IPOs
- Increase in the number of delistings
- Loss of economies of scale
- Etc (vicious cercle!!)

=> may lose leadership in price discovery process

New trading Venues - MTF

- BATS ChiX Europe
- Turquoise
- NYSE Arca Europe
- Burgundy
- TOM MTF

Characteristics of MTFs

MTFs remain a special kind of regulated markets

- High standards of price transparency
- Minimal trading fees
- Concentrate on blue chips (cherry picking)
- State of the art technology (latency times)
- Absence of primary market

Characteristics of MTFs

High Frequency Trading:

Main driver of liquidity but

- Driven by strategies correlated with intra day price dynamic
- Not driven by fundamental value analyses

Characteristics of MTFs

Source of serious and frequent market disturbances

Mini crash 6 May 2010

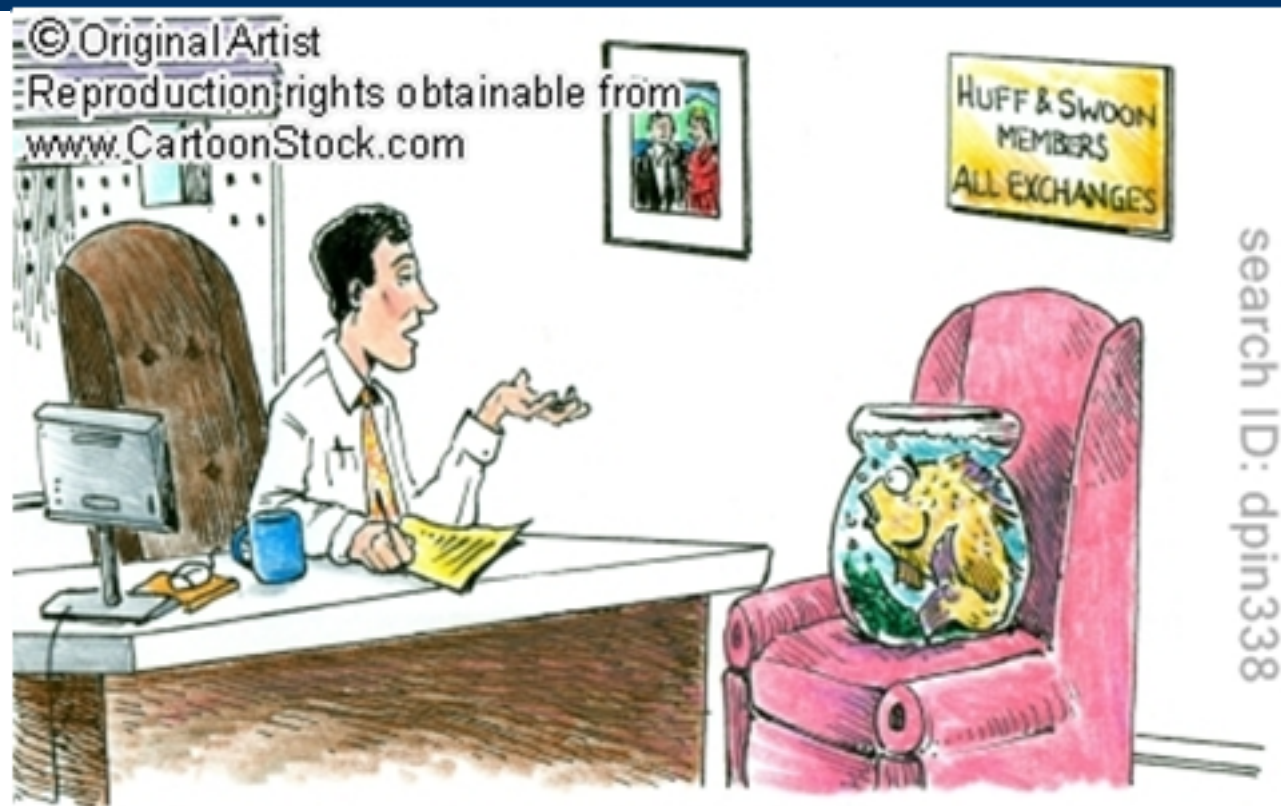
Knight Capital

Facebook IPO

BATS IPO

PSS World Medical: 47138 quotes in one second

Characteristics of MTFs



And why is liquidity so important to you?

Effect on MTFs

Bats-ChiX Europe now claims a 25% pan European equities market share (as per June 2012)

No more a passive platform

Leadership role in price discovery process

⇒ New (much cheaper) data pricing model as per October 1, 2012 (Bats Chi-X Europe goes to War on market data pricing)

Overall the MTF dramatically changed the European securities market

Dark pools and systematic internalisers

- Less dramatic
- Not so dangerous for regulated markets
- But still divert liquidity from more transparent trading venues (RM)

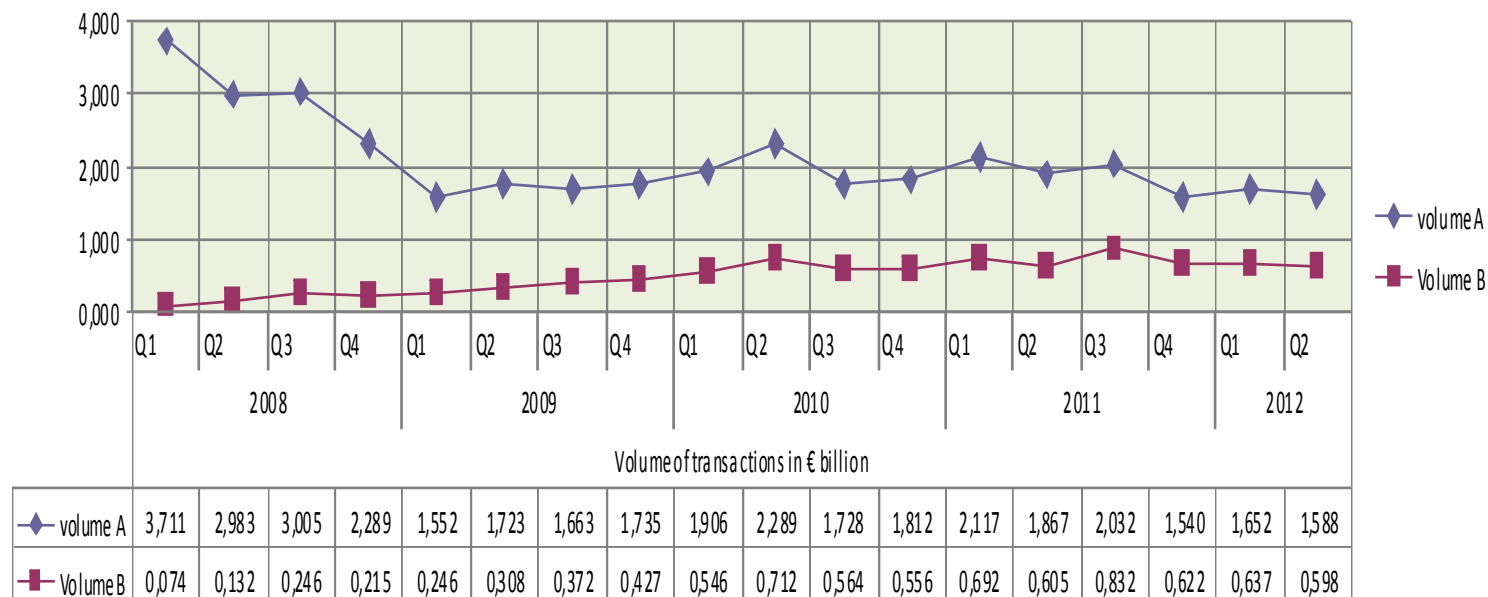
OTC Trading

- Impressive expansion
- Is there to stay
- Enjoys most freedom
- Escapes many transparency rules

Should be an exception and not a rule

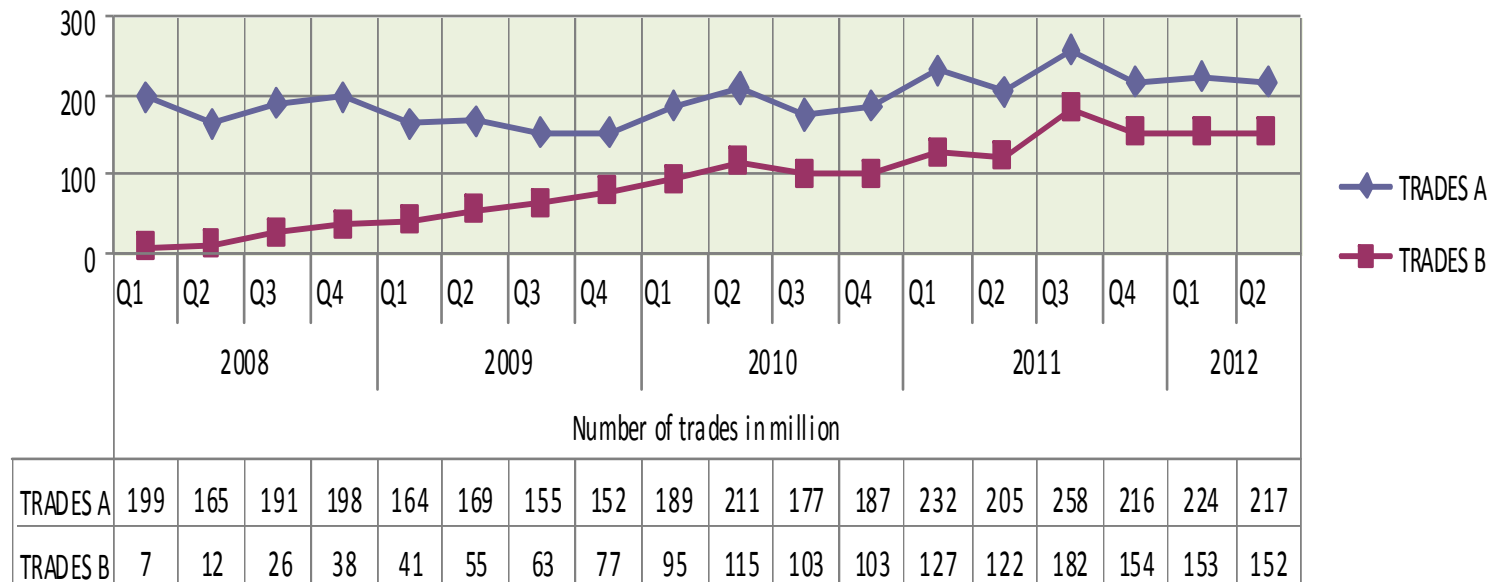
How do MTF compare with RM

Volume of transactions in € billion



How do MTF compare with RM

Number of trades in million



Impact on traditional role of RM

- Markets in blue chips are scattered around (too) many trading venues (Nokia traded on some 25 markets => no price transparency)
- RM may no longer be able to serve markets in SMEs and thinly traded securities
- Can medium sized RM still serve their national economies?

Role of EU Commission

- Concentrates too much on dismanteling or avoiding monopoly situation (e.g. veto against DBörse and NYSE Euronext merger)
- Should concentrate more on fundamental objectif of RM and their impact on real economy;
- US approach monopoly situations differently (DTC)

Mifid II

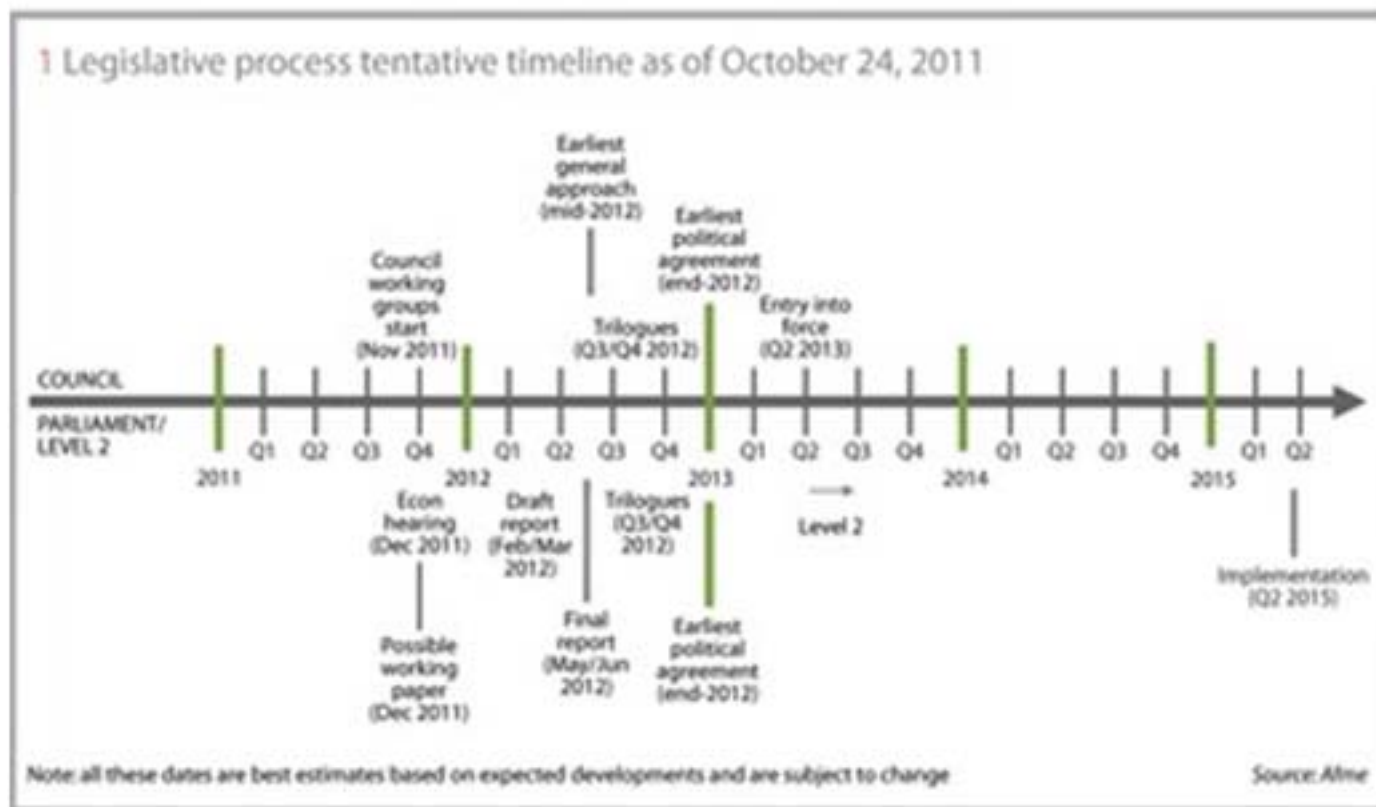
Proposals by the EU Commission:

- New OTF to capture OTC trading;
- New OTF to apply to all asset classes;
- New OTF multilateral (no trading on own account)

Mifid II possible consequences

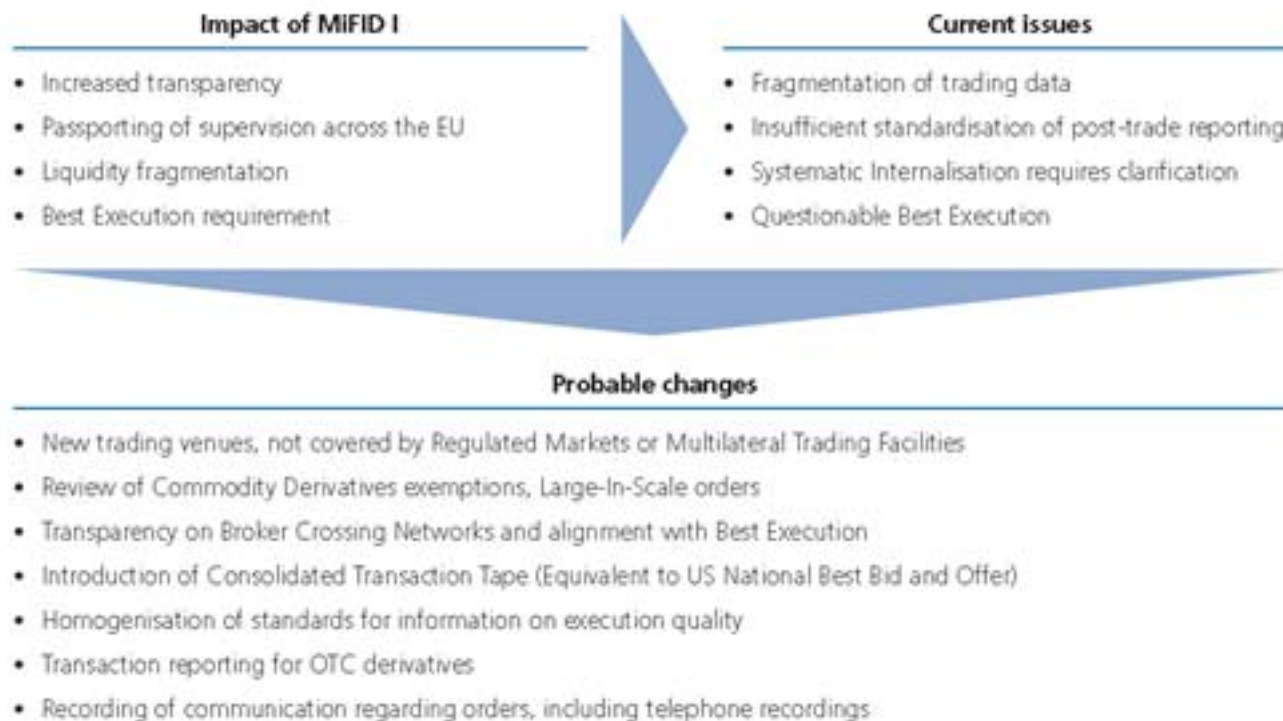
- New OTF still less regulated than RM and MTF
- RM and MTF may adopt new OTF status
- May not reduce OTC but weaken RM and MTF

Mifid II Implementation



Mifid II (source Grey Star)

Figure 2 Gaps in MiFID I to be addressed in MiFID II



Competition

The Effort of two or more parties acting independently to secure the business of a third party by offering the most favorable terms

Competition

« Nemo iudex in sua causa »

Mostly criticism of existing market situation
comes from players (=> conflict of interests)

Competition between market venues not
optimal

Conclusion

Are Europeans schizophrenic?

Oppose monopoly situation (which served the markets very well) but have no alternative model to achieve a sustainable result

Mifid I brought a lot of confusion

Will the financial transaction tax not add to this confusion?

Conclusion

- Europe losing ground and risks being sidelined
- Mifid II not enough and/or too late?
- Does not address the right issues (level playing field)
- Why did Europe not act more decisively on issues like Clearing and Settlement?

No competition authority for securities markets

Conclusion

William H. Donaldson: « Stock Exchanges are not immune from governance missteps »

But such missteps may shake the economy at large

Conclusion

Thank you for your attention

See you in 12-18 months to discuss this issue
again

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