

MARKET view

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**reshaping
for the future**

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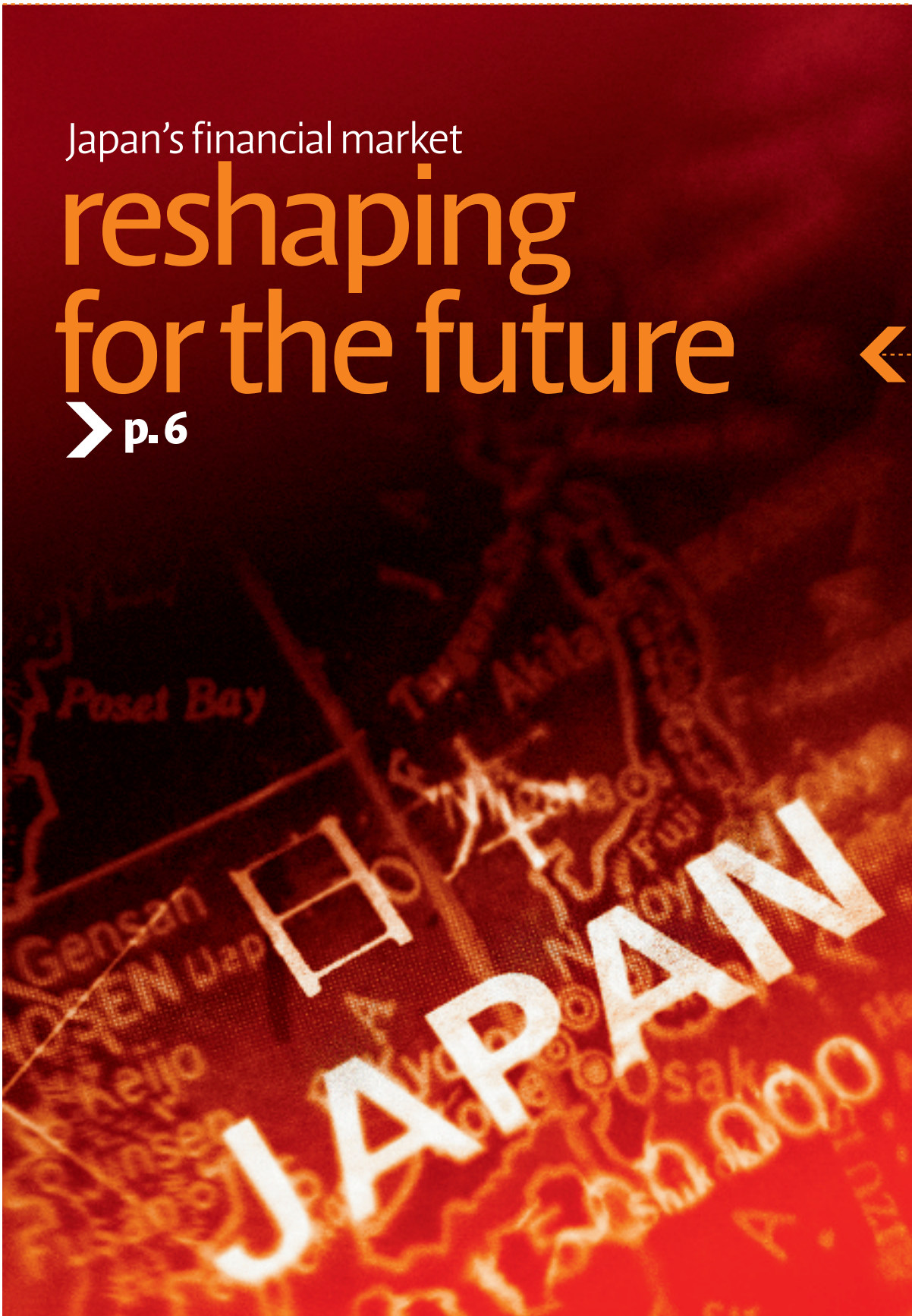




PHOTO: GETTY IMAGES

NYSE continues global growth strategy

The New York Stock Exchange Group and three other overseas investors signed an agreement to collectively buy a 20 percent stake in India's National Stock Exchange. The deal follows a recent decision by the Indian government to allow foreign investment in stock exchanges.

NYSE also announced a partnership with the Tokyo Stock Exchange "to jointly develop and explore new opportunities in trading systems and technology, investor and issuer services, investment products, and governance and regulation," which some observers see as a prelude to a possible merger of the world's two biggest equities markets. In December, NYSE shareholders approved its merger with Euronext.

OMX signs contracts with Zagreb and CASE

OMX signed agreements to deliver new trading systems to Zagreb Stock Exchange and Cairo & Alexandria Stock Exchanges (CASE) that will enhance the exchanges' IT infrastructure. A key goal is to contribute to the development of the local capital markets and to raise their national and international attractiveness.

Jukka Ruuska elected President of FESE

Jukka Ruuska, President of OMX Nordic Exchange, has been appointed President of the Federation of European Securities Exchanges (FESE) for a two year term.

Ruuska plans to build on the work of the previous President, Massimo Capuano, to foster the global competitiveness of exchanges as well as promote their public recognition and contribution to the European economy. With 24 members, FESE represents close to 40 securities exchanges from the countries of the EU and Iceland, Norway and Switzerland.



Jukka Ruuska

Commodities exchanges go all electronic

Several commodities exchanges have recently announced plans to close their open outcry operations, reinforcing the industry trend toward all electronic trading.

Budapest Stock Exchange ended open outcry commodities trading, and the Jakarta Commodity Futures Exchange was scheduled to do the same in early 2007. NYMEX planned to close its London-based open outcry exchange during the same timeframe.



European exchanges scale down clearing ties

Acceding to increased EU pressure to separate trading from clearing and settlement, both Euronext and Deutsche Börse have announced plans to distance themselves from their clearinghouse operations. Euronext will sell back both convertible and ordinary shares to LCH.Clearnet, reducing its stake in the clearinghouse to 5 percent. Meanwhile Deutsche Börse has proposed to legally separate its derivatives exchange, Eurex, from its settlement business, Clearstream. Under the proposal, each will operate as a separate entity under a single holding company.

Dark Pools of Liquidity growing market share

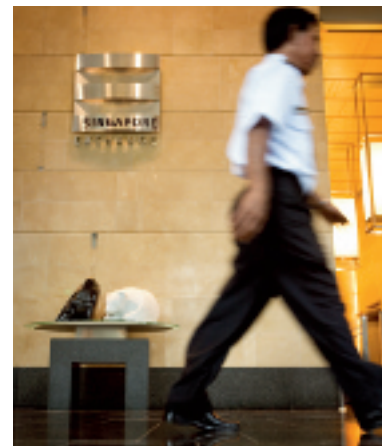
A recent TABB group report predicts that Dark Pools of Liquidity (a combination of crossing networks and internal markets) will triple their US volume from the current 420 million shares executed per day to 1.5 billion a day in 2010 to reach 15 percent of total equity market share.

At the same time, MiFID is directly affecting the development of dark pools in Europe with consortiums such as Project Turquoise and London's first independent platform – POSIT Now – setting up shop. The European markets could soon start to look like the early days of ECN trading in the US, according to the Tabb Group.

OMX signs agreement with SGX on new data feed system

OMX and Singapore Exchange Limited (SGX) signed an agreement to develop a new data feed system that will further enhance SGX's data dissemination services to market participants.

OMX will base the new solution on a market data system from Cicada and integrate it with SGX's trading engine, SGX QUEST. The solution is customized to SGX requirements and will be implemented in 2007.



Business development: a crucial ingredient to future success

Exchanges have come a long way in the past decade. In the wake of demutualization, most marketplaces have been transformed from mutually owned national monopolies into publicly traded companies whose owners require growth and profits. At the same time, deregulation has opened up cross-border competition and spurred the emergence of new players.

In this increasingly competitive environment, business development is crucial to future success. Exchanges have been forced to identify and meet the evolving needs of the market to ensure that they continue to grow their business. While incumbents have had varying degrees of success at this, they also have had many triumphs,

»The first step is to adopt an outside-in perspective. Understanding customers' business drivers and the resulting needs is key.«

including establishing light-touch regulation markets, such as LSE's Alternative Investment Market, and creating trading networks, such as OMX Nordic Exchange and Euronext's exchange network. And although competing for liquidity with a domestic exchange often has proved less fruitful, Singapore Exchange has successfully built and retained significant

market share in Nikkei 225 futures by solving the needs of international firms – for example, by providing longer opening hours.

New players have also emerged, finding niches for themselves after careful market research. In response to investors' demands for lower fees and faster execution, electronic communication networks a few years ago quickly captured a large share of the US market for NASDAQ-listed instruments. LiquidNet solved the demand for making large sized trades without moving the market by creating an anonymous block trading venue for institutional investors. Shareholder.com developed a suite of value-added services for issuers to complement the standard investor relations services provided by exchanges.

But there will always be new market needs to satisfy. Despite several attempts, a cost-efficient OTC clearing facility is yet to be established. The introduction of the new EU regulation MiFID has created several business opportunities. Under MiFID, firms entering orders on behalf of investors must select a market venue that fulfills "best execution" rules, taking into account not only the price of the instrument but also fees from the selected venue as well as clearing and settlement costs. This creates a need for a service that provides real-time best execution calculations. Within the clearing and depository segment, cross-border trading within the EU and Asia would be better facilitated if services were standardized and more integrated.

The conclusion? Exchanges that want to stay ahead in the market must

have a conscious strategy for business development. The first step is to adopt an outside-in perspective. Understanding customers' business drivers and the resulting needs is key. This involves segmenting and sub-segmenting customers and analyzing their roles in the transaction value chain.

At the same time, exchanges must be realistic about which kinds of services they can offer with reasonable credibility; an exchange's current position in the market can pose quality concerns or conflict-of-interest issues. Finally, in pursuing business development, exchanges have to accept that some bets will pay off and some won't. But those that don't try at all risk seeing their business slowly wither away. ■

Peter de Verdier
Head of Corporate
Development, OMX



PHOTO: ANDERS KRISON

Speed counts

The time it takes to send a message to an exchange and receive an acknowledgement has become increasingly important. Co-location of servers at an exchange's site is one way of reducing the latency.

BY SHERREE DECOVNY ILLUSTRATION MÅNS ADOLFSSON

The proliferation of algorithmic trading models is having a profound affect on the securities industry. Traders use algorithms to optimize execution by electronically breaking up orders, selecting which venue to send them to and launching the orders at just the right time. This practice was first popularized in the US, but before long it spread to Europe, and now it is also appearing in parts of Asia.

In this environment, roundtrip latency – the time it takes to send a message to the exchange and receive an acknowledgement – has become increasingly important. Latency is caused by a range of factors, including hardware and software performance, network hops, bandwidth and distance. The faster the response time, the sooner traders can react to this information by initiating new orders or changing existing ones.

GIVEN THE POTENTIAL for competitive advantage, algorithmic traders measure and monitor these numbers and use them to pressure exchanges and electronic communications networks (ECNs) to introduce latency-optimized solutions to improve performance. And nowadays, brokers in the US and Europe publish latency tables to gain marketing advantage.

This focus and arm-twisting has driven significant improvements in roundtrip latency in the past few years. “Seven years ago, the brokerage community’s key benchmark was a per second response time with a subsequent move to hundreds of milliseconds,” says Hirander Misra, FVP - Head of Strategic Product Development & Director of Instinet Chi-X Ltd. “Now it is just a small number of milliseconds, with a move towards microsecond benchmarking.”

MARKET PARTICIPANTS have devised a few ways to reduce latency. Closer typically means faster, so some clients have co-located their servers in their broker’s or network provider’s data center, which houses the gateway connections to the exchanges. When the client and the exchange are both in the UK, this eradicates the four millisecond roundtrip latency of the local connection in London. For a US-based client trading in London, eradicating the “pond hop” can save at least 100 milliseconds roundtrip.

But co-location does not solve the whole problem. Since market data providers add a latency delay of about 250 milliseconds, traders may be sending orders to the exchange faster than the trades are reflected in

»For a US-based client trading in London, eradicating the “pond hop” can save at least 100 milliseconds round trip.«

the market data. To solve this issue, some clients have started taking direct data feeds from the exchanges and interfacing them with their applications. And now information vendors provide ultra-low latency full-tick feeds, direct from exchanges. For example, Reuters offers a service benchmarked to an average latency of less than one millisecond.

Even with co-location, many exchange systems are still slower than ECNs because messages sent from the client’s server are validated in an API layer before going to the core matching system. Each additional step or process adds latency.

THE QUESTION IS whether latency can be reduced further. Adopting the FIX Adapted for Streaming Market Data (FAST) Protocol can help exchanges handle large volumes of data and reduce latency. At the simplest level, FAST is FIX that has been adapted using compression algorithms. It reduces the size of the messages up to 80 percent. Smaller messages can travel faster, so they get to the counterparties quicker. They also require less bandwidth, which yields a cost savings.

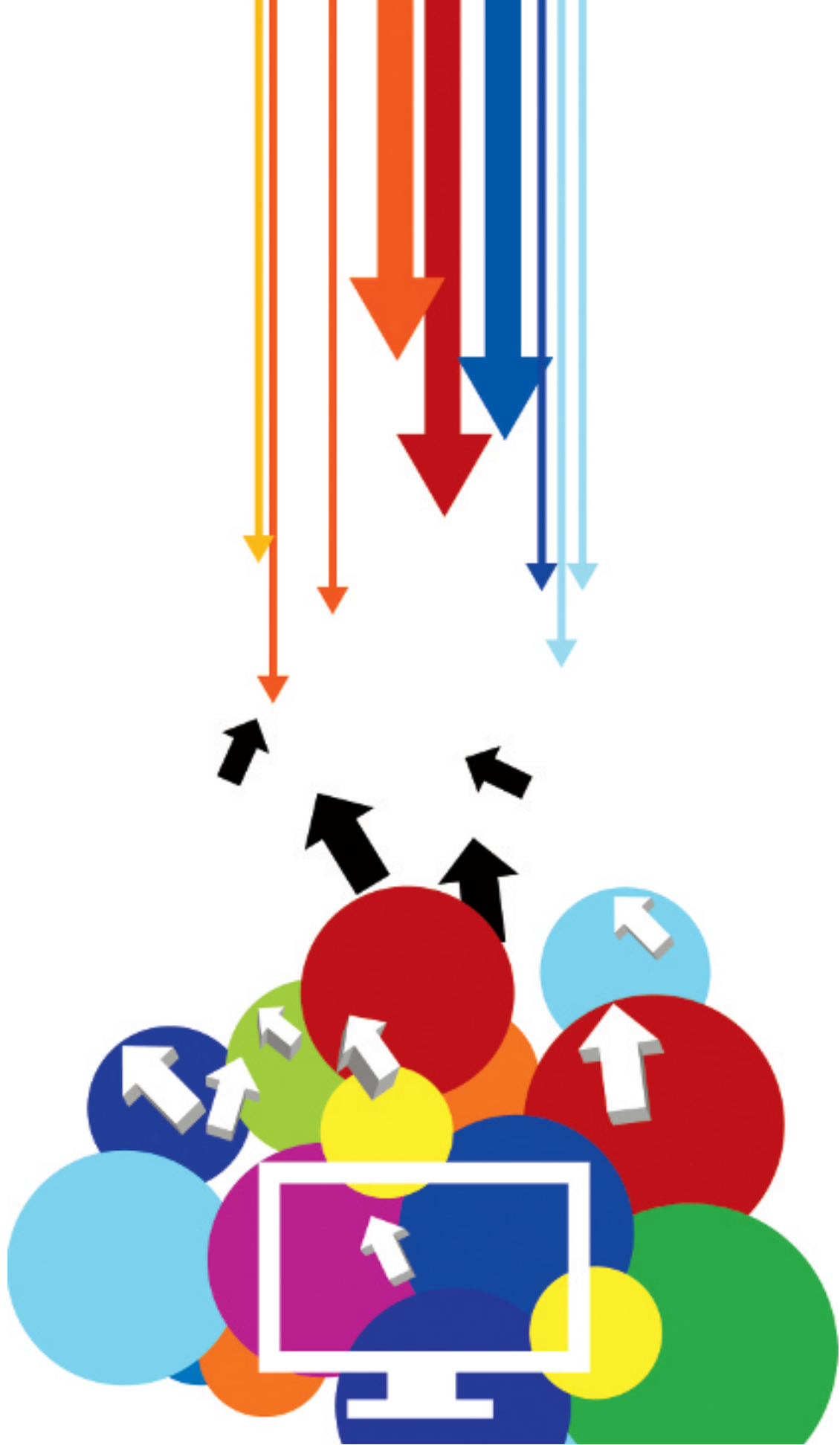
Still, commodity technology has its limitations, says Peter Lundgren, Product Line Manager at OMX, and

pushing the envelope too far would compromise flexibility, robustness and stability. Latency normally can be reduced further at the expense of properties such as transaction throughput and resilience. But in his opinion, reaching significantly below millisecond latency also requires specialized technology solutions such as more exotic network equipment or even bypassing layers in the communications stack on the network cards.

THIS IS FEASIBLE, but the investment curve can be steep. “Using commodity technology, it is theoretically possible to reach figures below 100 microseconds for a single hop between two machines today,” he says. “If you want to improve further on that, the cost for achieving an extra 10 microseconds rises significantly, since you can no longer rely on commodity equipment.”

Before going down this route, exchanges should define their niche and decide what type of operator they want to be. Then they need to combine technology and services that provide the best compromise. Like broker and network providers, exchanges can offer co-location services. Exchanges can also host part of clients’ trading algorithms in their data center, although traders may be reluctant to do this because they want to protect their intellectual property.

Exchanges need to evaluate their decision in light of increased competition in the post-Regulation NMS and MiFID environment. Those that do not take a proactive approach will be left behind. ■



Japanese markets: preparing for the next wave

In recent years, Japanese markets have witnessed increased retail and online trading, as well as foreign investment. They are learning to adjust to global competition and are making considerable progress in adapting their technology and regulatory framework to meet international standards.

BY JAN HÖKERBERG PHOTO GETTY IMAGES

Traditionally, Japanese markets have been order-driven, without market-making or special services to accelerate trading and increase liquidity.

Nevertheless, the large size of the Japanese economy has been enough to inject plenty of liquidity into its markets, where there are now more than 3,000 stocks listed.

In recent years, liquidity and volume have increased considerably, due to Internet trading from retail investors and because the government has introduced incentives for investing in the stock markets to generate greater investment returns.

The liberalization of the stock markets began in the late 1990s. More recently, the markets have undergone major regulatory changes to enhance fairness and transparency. In the short term, this has created a downturn in turnover, especially for the commodities exchanges, but analysts regard the changes as necessary and are confident that Japan's markets will benefit in the long term.

"There has been a clear strengthening of the regulatory environment

both on the financial and the commodities markets," says Julien Le Noble, Managing Director of the French brokerage firm Fimat in Japan.

IN 2006, a new legal framework was introduced, abolishing and consolidating four laws into the new Financial Instruments and Exchange Law (FIEL). Changes were made to the definition of securities, the scope of derivative transactions, disclosure rules and tender offer rules, along with other significant provisions.

"We welcome the new law," says Le Noble, "since it will strengthen the Japanese financial marketplace, increase transparency and raise its international position."

The recent growth in Japan's markets also derives from continuous demands from foreign investors, who have started to trade heavily in Japanese markets.

Both domestic retail investors and foreign investors depend on high quality technology systems, since many of them use program trading techniques such as algorithmic trading.

Exchanges in Japan were among



»I would not be surprised if in three to four years' time, Japan has only four or five exchanges.«

Julien Le Noble,
Managing Director
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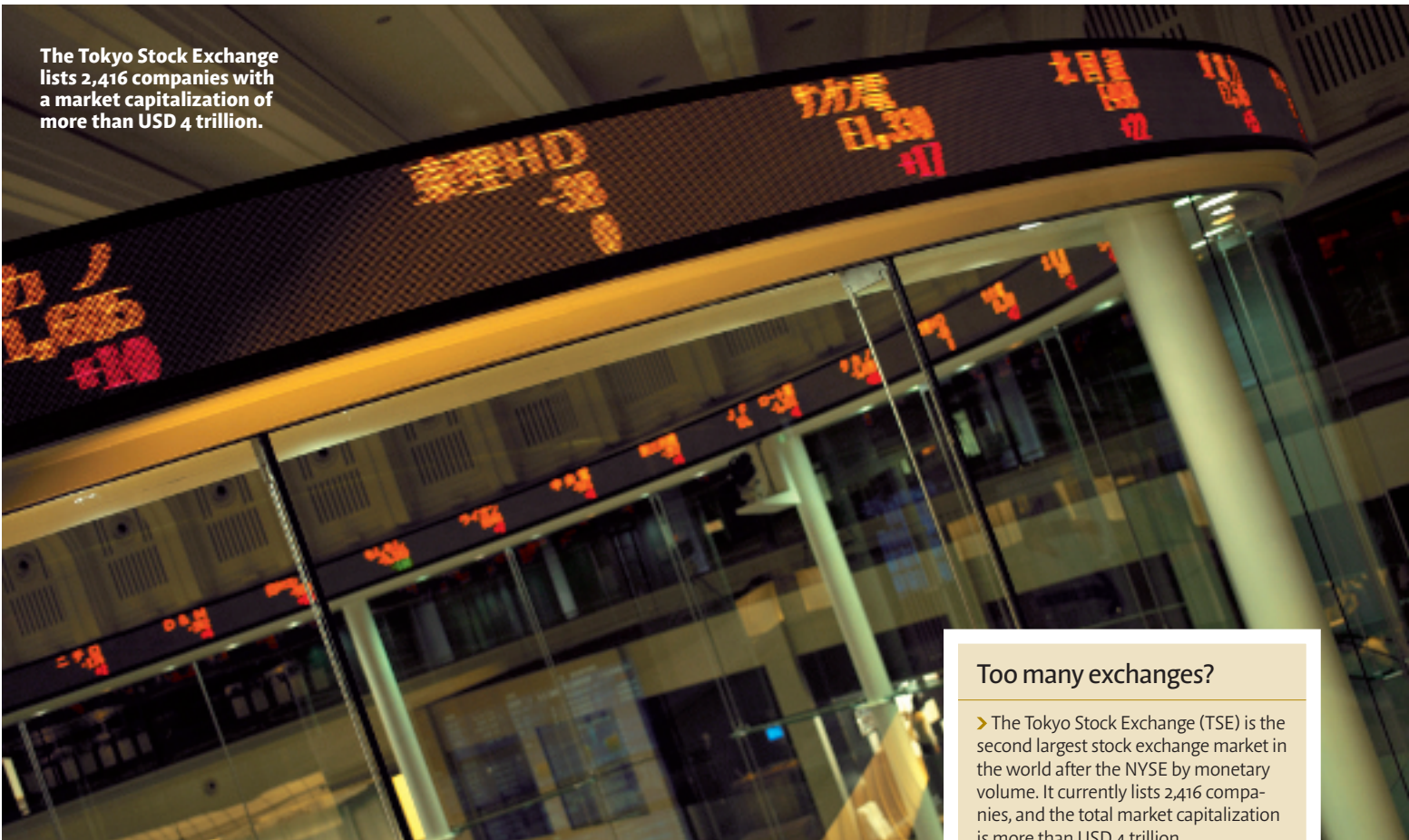
the first in the world to use electronic exchange systems, but these systems have not been developed significantly for the past 10 years, due to the bearish equity markets. So while trading has increased, it has led to incidents among exchanges such as system delays, suspended trading, program bugs and capacity problems.

"People may think that Japan is a technology-driven country, but at the exchanges sometimes not even fundamental technology works," says Kenichi Ohmae, Managing Director and founder of Ohmae and Associates and a leading management consultant and global business strategist.

OHMAE SAYS that the main reason for the delay in technology development is that most exchanges have been operated mainly from a regulatory perspective as government or semi-government organizations and, as such, tried to protect individual investors from being exposed to risks associated with modern financial assets or trade practices.

Another obstacle is the ownership structure of exchanges. Japanese

The Tokyo Stock Exchange lists 2,416 companies with a market capitalization of more than USD 4 trillion.



exchanges are mostly owned by associations of brokerage firms and commodity trading firms, many of which are small and middle sized traditional local firms that are not particularly interested in introducing modern practices. Limited resources in, for example, management with good industrial knowledge and language capabilities also make it difficult for Japanese exchanges to communicate with foreign marketplaces.

ONE EXCEPTION IS the Osaka Stock Exchange (OSE), which is the only listed Japanese exchange. The OSE listed on its own Hercules market for startups in April 2004. Being a publicly listed exchange automatically leads to greater transparency and makes management more aware of the need to look for new opportunities.

“We can see now that the OSE is talking about improving its technology and finding new business models,” says Ohmae.

The success of the OSE listing has led its major rival, the TSE, to plan its own listing in 2009 when its new domestic system is implemented.

There is talk in Japan that the number of exchanges may be significantly reduced. The government seems to have adopted this idea, while market participants are more cautious and say that competition is necessary.

The Japan Securities Dealers Association is said to be considering a proposal to merge the TSE and five other stock markets and reorganize them into several new bodies under a holding company by 2009.

“We can see a trend that the government and members of financial and commodity industry associations encourage mergers,” says Ohmae. “It is something that the markets welcome, and they would also like to see the exchanges listed to improve transparency.”

“I would not be surprised if, in three to five years’ time, Japan has only four or five exchanges,” concludes Le Noble.

HOWEVER, IT SEEMS clear that both the OSE and JASDAQ—a securities exchange headquartered in Tokyo that operates an electronic trading system similar to NASDAQ in the US—want to keep their autonomy and not be

Too many exchanges?

➤ The Tokyo Stock Exchange (TSE) is the second largest stock exchange market in the world after the NYSE by monetary volume. It currently lists 2,416 companies, and the total market capitalization is more than USD 4 trillion.

The Osaka Securities Exchange (OSE) is the second largest exchange in Japan. The Nikkei 225 Futures, introduced in 1988, is an internationally recognized futures index. The OSE lists 1,072 companies, but corporations often opt to trade their stocks on both the TSE and the OSE. The OSE is the leading derivatives exchange in Japan and the only Japanese exchange that has gone public.

The Tokyo International Financial Futures Exchange (TFX) is another specialized exchange for derivative products.

JASDAQ is a new securities exchange that operates an electronic trading system similar to NASDAQ in the US. NASDAQ and JASDAQ markets are unique in their use of market makers to quote prices, rather than being order-driven.

Three smaller stock exchanges, in Nagoya, Fukuoka and Sapporo, operate only on their local markets.

One effect of the regulatory changes is the ongoing consolidation process among commodities exchanges in Japan. Compared with seven in early 2006 and 16 in 1989, there are now four commodities exchanges in Japan: the Tokyo Commodity Exchange (TOCOM), the Central Japan Commodity Exchange (C-COM), the Tokyo Grain Exchange (TGE) and the Kansai Commodity Exchange (KEX).

placed under, for example, the TSE.

TSE and the Japanese exchanges are increasingly looking for regional and global partnerships. In 2002, the TSE signed a memorandum of understanding (MoU) with the NYSE, which was followed up by a strategic alliance agreement early this year. TSE recently signed a partnership agreement with the LSE regarding product development and technology sharing. TSE also has MoUs with the Korea, Shanghai, and Taiwan stock exchanges and other exchanges around the world.

FROM A TECHNOLOGY POINT of view, Japanese exchanges use solutions mainly from Japanese system providers. The solutions are tailor-made for the market and are difficult to adapt and integrate with international marketplaces. However, marketplaces in the region are looking into competing on the Japanese market by bringing in foreign technologies.

“Foreign exchanges can bring in different cultures and different market models to Japan,” says Ohmae. “It would be welcomed if they should try to open their own exchanges in Japan and improve Japanese financial markets. They already have relations with investors abroad, and they have proved that their market models work.”



An interesting development is the Proprietary Trading System (PTS), which was introduced in 1998 and is a private broker-to-broker market. “I would not be surprised if the PTS market would gather liquidity with superior technology to the level to compete with traditional exchanges,” says Ohmae.

For the commodities futures markets, a new Commodity Exchange Law was put in place in 2005. The main purpose was to make the market more reliable and established and to ensure that all assets deposited by customers are protected and segregated as properties belonging to customers.

The 2005 law clamped down on

»...at the [Japanese] exchanges sometimes not even fundamental technology works.«

Kenichi Ohmae, Managing Director of Ohmae and Associates.

certain sales techniques, such as cold-calling, and asked for clearer separation between the accounts of customers and brokerages. With the establishment of the Japan Commodity Clearing House, brokerages were forced to deposit clients' margin funds with a central authority.

“The purpose of establishing the clearing house was to protect customer interest and enhance market integrity,” says Yasuo Mogi, Senior Executive Vice President of Himawari Securities in Tokyo. “It is time for Japan to create a modern structure and invite international participants. The goal is that our trading shall not rely on speculators. We have to make moves for the markets to be more professional.”

FOLLOWING THE NEW LAW, commodities futures market activities have sharply declined, since these markets had largely been driven by speculators. It has also led to a reshuffle among brokerage firms, since the new law also stipulates deregulated fees and new costs.

In Le Noble's view, the benefits of the new law will outweigh the costs, since in a couple of years international investors will look at Japanese markets with much more confidence and willingness. ■

A brighter future

Ever since the bubble economy burst in 1990, Japan has been on a path to recovery. Today, the nightmare seems to have ended, and corporate earnings are on the rise.

IT HAS NOT BEEN an easy ride for the world's second largest economy. For more than a decade, Japan has been struggling to make a comeback, trying to wake from the nightmare caused by the bubble economy in the late 1980s, when real estate prices and stocks skyrocketed due to heavy speculation.

When the bubble burst in 1990, the country's banking system was crippled by bad debts. In the aftermath, companies experienced

negative cash flow, asset prices fell, consumers held onto their money, deflation ruled and the economy stalled.

“However, since 2002, Japan's economy has witnessed a record-long expansion period,” says Kenichi Ohmae, Managing Director of Ohmae and Associates. “Companies have started to reinvest, and many industries have undergone necessary consolidations.”

In 1999, the Bank of Japan cut

interest rates to zero, and they are still the lowest in any industrial country. In 2001, the central bank adopted a policy of quantitative easing of the money supply and backed up the banking system with cash injections in an attempt to get banks lending again.

The injections seem to have worked. Corporate earnings are on the rise, and in 2005, the Nikkei index was up 40 percent with continued growth in 2006.

Italian market operator and owner TLX has prepared itself for MiFID, a new European legal framework. When MiFID is introduced in November 2007, TLX is well positioned for growth.

BY SHERREE DECOVNY PHOTO COURTESY OF TLX

Taking advantage of MiFID

Italy's financial markets are well developed, and its retail investors are sophisticated.

Unlike their US and UK counterparts, they prefer to manage their own portfolios instead of buying mutual funds. As a result, Italian investors have high demands for the efficient trading of a wide range of securities. Traditionally these needs have been hard to satisfy, particularly in the fixed income market where each banking group has its own internal marketplace, typically with low price transparency and product information.

That scenario will change with the introduction of the pan-European Markets in Financial Instruments Directive (MiFID) in November 2007. As competition increases in the European financial markets, TLX, an Italian market owner and operator, is well positioned for growth.

OPERATING SINCE January 2003, TLX is jointly owned by UBM, the investment bank of the UniCredito Group, and Banca IMI (Sanpaolo IMI Group). TLX operates two markets targeted specifically to the demands of retail investors: TLX, a regulated market and EuroTLX, an Alternative Trading System [or a Multi-lateral Trading



Alessandro Zignani believes TLX is well positioned for growth.

Facility (MTF) under MiFID].

It is run as a nonprofit utility earning money on the spreads, as its owners are also market makers on all instruments traded. They post competitive bids and offers on TLX during normal trading hours, while pre- and post-trade information is posted on the TLX web site (www.eurotlx.com). Around 1,800 instruments are traded on the two markets, including corporate and structured bonds, US and European government securities, sovereign emerging markets bonds and

»We can provide a high quality service to the banks at a more competitive price.«

Alessandro Zignani, managing director of TLX

European and American equities.

TLX sees MiFID as a way to gain competitive advantage in Europe. Its strategy is to first gain critical mass in Italy by leveraging its two market makers to attract order flow and offer best execution for retail investors. Another advantage offered to the brokers is that there are no fees for membership and trading.

NEXT, IT WANTS TO expand domestic participation on the platform. Once MiFID takes effect, every Italian bank must decide whether to invest in its internal markets, close that business, or find a partner. TLX's vision is to offer the Italian banks a cost-effective solution by sharing its infrastructure, including its hardware, network, application and system software, and taking advantage of outsourcing opportunities.

Then more financial instruments will be added to the platform. TLX does not plan to offer domestic equities; however, it will continue to offer a small selection of US and European blue chips that can be settled domestically.

"We can offer retail investors good liquidity on foreign equities," says Alessandro Zignani, managing director of TLX. "Currently, it is expensive for the banks to go through a foreign broker to execute a cross-border transaction. We can provide a high quality service to the banks at a more competitive price."

Finally, Zignani believes TLX's business model will entice European banks to participate as market makers. Since the market makers are also the shareholders, they have a strong commitment to ensure the platform's success. ■

The challenge: To promote and develop TLX markets to take advantage of the opportunities created by the new European legal framework.

The solution: Partner with OMX to provide a fully outsourced trading system (CLICK XT) that includes a managed application, technical operations, facilities management and member help desk, enabling TLX to remain a lean organization while providing the flexibility needed to grow its business.

Exchanges hedge their bets on diversification

Investors are not the only ones diversifying their holdings. Exchanges are busy expanding their offerings to include the trading of new asset classes and more instrument types. This strategy not only minimizes risk and boosts earnings, but it also presents customers with more choices.

BY CHARLOTTE WEST PHOTO MATTIAS BARDÁ ILLUSTRATION MÅNS ADOLFSSON

Both NYSE and NASDAQ have recently announced that they will be trying their hands at the options business, while the Chicago Board Options Exchange launched the CBOE Stock Exchange in March 2007. They will be joining the Boston, Philadelphia and American stock exchanges, which currently support both equities and options. Similar trends have been prevalent in Europe, Asia and Australia, with many exchanges offering both cash and derivatives products.

Diversification in asset classes is also on the rise. For example, Euro-next has recently introduced trading in commodities, such as raw sugar and rapeseed oil. According to Peter Redshaw, Research Director of Investment Services at the Gartner Group, exchanges are moving towards trading multiple instrument types and new asset classes to satisfy customer demand and to add revenue streams.

“Customer demand is moving increasingly towards structured products,” Redshaw says. “Customers want

exchanges that can cope with more asset types. It also works for exchanges because they want to divest, reduce volatility and capture a bigger share of the market.”

IF CUSTOMERS ALREADY have the expense of connecting to an exchange, it only benefits them to be able to access different kinds of financial instruments in one place. However, Redshaw argues, this may not be the optimal model.

“At Gartner, we think a much better model is emerging,” he explains. “Rather than being tied to one exchange, we see business process networks [BPNs] being able to provide access to many exchanges from one customer connection. BPNs will act as the insulating layer that offers choice but minimizes the impact of change. It is the next stage in the evolution of open access to exchanges after direct market access. Customers will have simple access to exchanges on a plug-and-play basis. The trick for an exchange will be to make itself the ‘destination of choice’



»Industry consolidation...means changing – rather than disappearing – roles for smaller exchanges.«

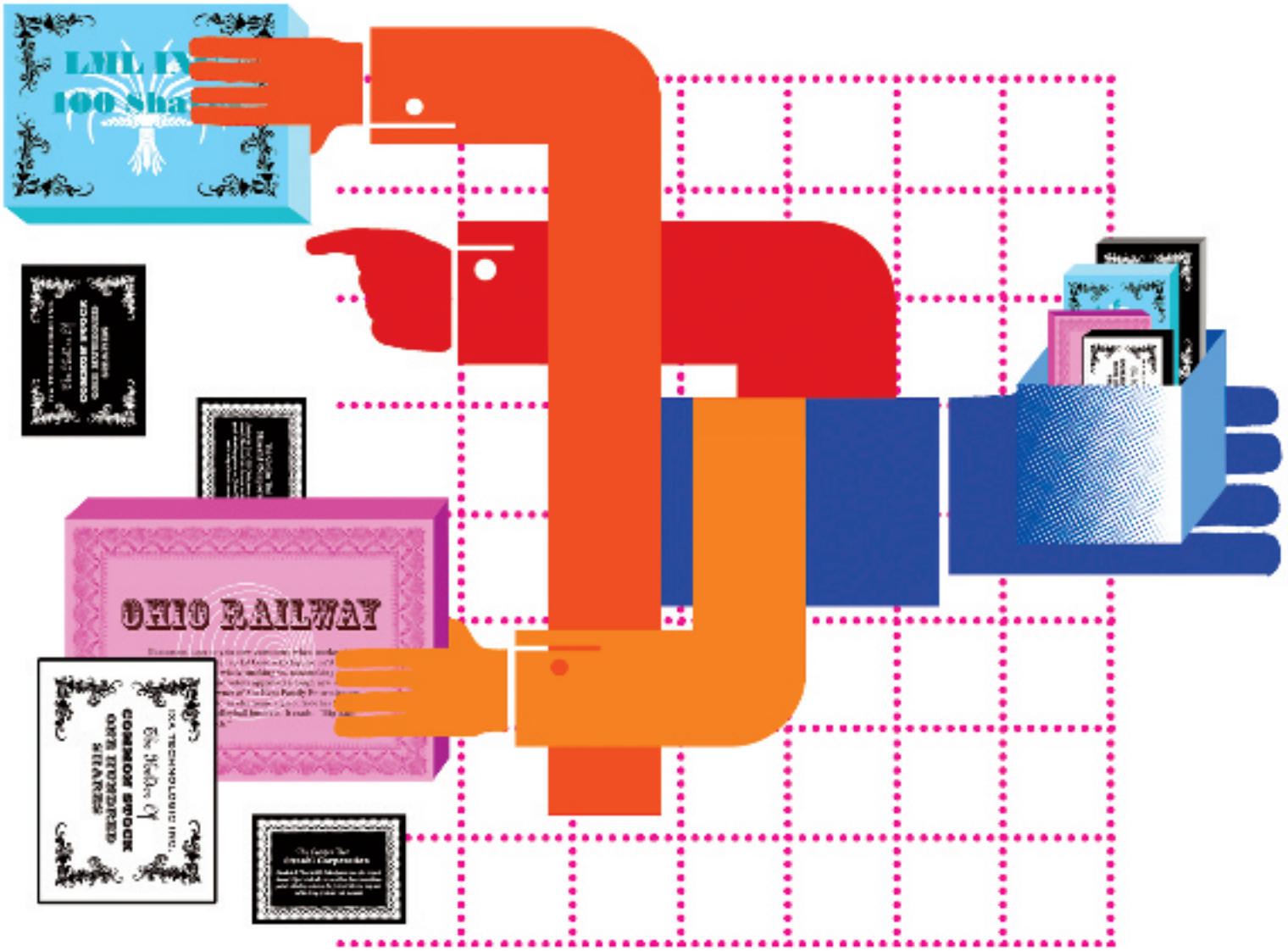
Peter Redshaw, Research Director of Investment Services, Gartner Group.

for as many BPNs as possible.”

The launch of the ISE Stock Exchange by the ISE is a good example of the shift towards new business strategies. The ISE operates the first fully electronic options exchange in the US and has grown to be among the world’s largest options exchanges since its debut in 2000. In October 2006, ISE cut its teeth in the stock business when its MidPoint Match product – a continuous, anonymous and fully automated matching platform – went live. The ISE completed rollout of its stock exchange in February 2007.

“The opportunity to wade into adjacent space and leverage our expertise to deliver value into another arena where we perceived a need struck us as something to explore,” says Tom Ascher, the ISE’s Chief Strategy Officer.

ANDREW BRENNER, head of the new stock exchange, says it has drawn upon its membership, regulatory infrastructure, operational support, and connectivity to expand from



options into stocks. The ISE's options know-how as well as recent changes in US legislation created an attractive opportunity to expand into a new instrument type.

"Reg NMS certainly helped us in making the decision because now orders that are placed on the ISE have price protection and are treated just as orders are treated on NASDAQ or NYSE," Brenner says.

The key has been to provide a differentiated product that offers its customers the opportunity to trade both stocks and options via their membership.

"There is absolutely no need for an additional exchange in the US," Brenner says. "Unless we could come up with a product that differentiated the ISE from the other exchanges out there,

we weren't going to move forward."

Industry consolidation seems to be an inevitable outcome of converging markets, but it means changing – rather than disappearing – roles for smaller exchanges. Redshaw predicts that despite the industry consolidation, with examples such as the NYSE's acquisition of ArcaEx and NASDAQ's acquisition of BRUT and INET in 2005, small niche "boutiques" will emerge alongside the industry majors. "There is no place for smaller markets doing the same thing as NASDAQ," he says.

"Despite the high profile mega-mergers between exchanges, competition and diversity will remain. Changing regulations and new technologies will mean that monopolies will continue to be challenged, despite the

huge economies of scale and liquidity that some of the global players will have. Going forward, exchanges will continue to diversify in terms of their offerings, not just to provide markets with more instruments, but also to provide additional services."

SO WHAT'S THE NEXT logical step now that the single instrument type or one asset class exchange seems to be endangered?

The next challenge will be technical: integrating trading platforms to enable new services like real time combination trading of cash and derivatives. ASX in Australia has already launched an integrated trading platform, and Singapore's SGX is on its way to doing so. Can the US exchanges be far behind? ■

Creating a financial powerhouse

A self-made billionaire who has combined outstanding business skills and risk taking to reach the top of the global financial markets, ICAP's founder Michael Spencer's ultimate goal is to turn his company into a global OTC exchange.

BY COSIMA MARRINER PHOTO COURTESY OF ICAP

As the chief executive of ICAP, Michael Spencer is one of the public faces of the British financial establishment. He is a self-made billionaire and one of the most powerful players in the City of London. He has combined his outstanding business skills with a willingness to take risks to drive ICAP to the top of the global financial markets. ICAP is now the world's largest interdealer broker, matching buyers and sellers of complex financial instruments and completing deals worth more than USD 1.2 trillion each day.

Spencer became interested in financial markets after making GBP 300 on a trade while studying physics at Oxford University. After starting his career in the City, Spencer moved to a smaller brokerage firm and was attracted to the fledgling market for interest rate swaps, which are used to hedge against interest rate fluctuations. He secured backing to start his own business, ICAP, just when the swap market began to boom, carrying Spencer's outfit with it. ICAP grew over the following 10 years from the original four people to more than 300 worldwide.

ICAP has since expanded further, often by mergers and acquisitions, into US Treasuries, corporate and government debt, foreign exchange, energy and equity derivatives. The company now accounts for just under one third of the international interdealer broking market and is aiming for a 35 percent share.

»His ultimate goal is to turn ICAP into a global OTC exchange.«

But traditional interdealer brokers such as ICAP are increasingly facing challenges from electronic broking, so Spencer cannot just rest on his laurels. He saw the potential of electronic broking early and in 2000 committed to create a combined voice and electronic business. In 2003 ICAP acquired BrokerTec, the fixed income platform, and recently paid \$825m for EBS Group, which runs a global electronic currency trading system. He has also made it clear that he wants to push into the share



Quick facts on Michael Spencer

Current position: Founder and Group Chief Executive Officer, ICAP

Personal: Married with two sons and a daughter

Recommended reading: *Stalingrad* by Antony Beevor

Leisure pursuits: Running, riding, wine, art, politics and political history.

trading business and be involved in any challenge to the dominance of major exchanges by providing infrastructure. His ultimate goal is to turn ICAP into a global OTC exchange, one that will thrive well beyond his own career.

When he is not building ICAP's business, Spencer is active in Britain's Conservative party. He currently co-chairs the Conservative City Circle, a group of City executives that advise party leaders on business matters, and he has also recently been appointed the Conservative treasurer, responsible for the party's fund-raising team. He also does find time to relax. Passionate about wine, Spencer counts more than 10,000 bottles in his wine collection.

The world's financial markets and brokerage businesses are in a state of flux but Spencer, with his aggressive stance and eye for growing markets, is well placed to exploit any opportunities. ■

Market View

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