COLLABORATION VS CONSOLIDATION

PETER KELLER, FORMER CEO OF VIRT-X EXCHANGE LTD, iCEO #17577, SWITZERLAND

The recent meeting of the Federation of European Securities Exchanges (FESE) brought together some famous faces from the trading world to discuss what comes next following a particularly volatile six months. In early 2005, with news of Deutsche Borse's proposed bid for the LSE and the possibility of Euronext also entering the battle, many in the industry thought the years of talk about European exchange consolidation would finally result in some action. Much time has been devoted to discussion of the 'inevitable' consolidation of European exchanges, yet now we are facing an interesting future. With the new accession countries there are more European exchanges than ever before; shareholder intervention stymied Deutsche Borse's initial ambitions to buy the London Stock Exchange (LSE), and with the referral of any bid to the Competition Commission for at least another few months, some wonder whether potential bidders are still keen to pursue their target. But most importantly, the market needs to address whether exchange consolidation is in the interests not just of shareholders in the respective companies but also of the wider European trading community?

The Office of Fair Trading (OFT)'s decision to refer Deutsche Borse's LSE bid to the Competition Commission reflects the broader market's fears about reduction of competition, not only in the area of on-exchange trading services for equities in the UK, but also on the clearing of those trades. Regular conversations with stock exchange members indicate that lack of competition is the key concern in any move to consolidate exchanges. A merger of two large exchanges could result in a decrease in competition which, in turn, takes pressure off providing the most cost-effective solutions for users and also decreases the incentive to evolve and innovate – essential in the fast-paced and technologically advanced world of trading. Therefore, rather than continued consolidation to create large, powerful exchanges and thus reduce potential competition, a more effective business1 model for the market may be to encourage collaboration. This would result in a more competitive range of equity trading services from front to back office with traders able to pick best of breed provision depending on the situation.

This coopetitive approach is already developing across the industry (as alternative trading platforms and technology providers across asset classes work to provide flexible component solutions, competing with what has traditionally been the exclusive domain of exchanges). Demand is not only for competitive pricing, liquidity and efficient services but also for a network that has flexible, global connectivity, often best created through strategic alliances rather than mergers. Borsa Italiana signed a co-operative agreement with the Tokyo, Shanghai and Shenzhen Stock Exchanges to strengthen business relationships and expand the reach of their markets. Clearstream have signed an MOU to explore regional initiatives with Chinaclear, the securities depository for the Chinese capital markets, to explore the potential of delivering improved post-trade services. Going back further there is proof of successful alliances that have created market leading organisations: in 1997 SWX group and Deutsche Borse created the joint venture of Eurex, the derivatives trading platform which runs from one record growth to the next. Furthermore, clearing and settlement providers have already illustrated a willingness to co-operate with each other and with the exchanges. Clients of virt-x have long had a choice of clearing through either LCH.Clearnet Ltd or SIS x-clear, and three settlement options: CrestCo, Euroclear Bank and SIS SegaInterSettle. This allows members to choose the best infrastructure either based on price or on suitability with their business model. Clearing and settlement providers are also working together through collaborations in other asset classes, for example the Italian co-operation between LCH and CC&G in government bonds (and the agreement between LCH.Clearnet Repoclear, Euroclear and Government Securities Clearing Corporation (GSCC) to form European Securities Clearing Corporation (ESCC)).

1 Of course there are customers (market participants) and suppliers (Clearing houses and Central Securities Depositories) and without them Stock Exchanges wouldn't be in business. And naturally, there are competitors. Is that it? No, not quite. There's one more, often overlooked but equally important group of players those who provide complementary rather than competing products and services.

Broader interoperability and choice maintains competition, particularly in pricing, but also allows speed and flexibility of trading and the subsequent clearing and settlement.

The recent announcement of Switzerland's SIS Group, that won the right to clear LSE share deals, demonstrates the determination to undercut LCH.Clearnet, the company that currently has a monopoly of LSE clearing.

There is no doubt that the European exchange landscape is rapidly changing, and the industry needs to constantly evolve to keep up with increased globalisation, changing regulatory requirements and client demand. But competition is a key part of the market and there are alternatives to the merger and consolidation route. Collaboration and co-operation within the market enables all parties to maintain their autonomy, promotes competition and can improve pricing, connectivity and execution for the trading community, rather than just short-term value for shareholders.