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Derailing the NYSE and Deutsche Börse Merger

Allan D. Grody February 1, 2012

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The merger vision of the NYSE and Deutsche Börse, agreed to by their respective shareholders and US regulators has been thwarted by European regulators' misunderstandings of the evolving financial system. The EC disapproved the deal disallowing that innovation is necessary to compete in the technology intense and globally connected financial system that is the hallmark of our evolving capital, contract and currency markets.

The expressed concern of the EC was that the $10 billion merger would put more than 90 percent of the region's exchange-traded derivatives market and about 30 percent of European stock trading in the hands of one company. From the merger partners perspective Deutsche Börse which operates Eurex Group, the second largest derivatives market in the world, and NYSE Euronext which operates NYSE Liffe, the third largest wants to compete on a worldwide basis with amongst others the CME Group, and its Chicago Mercantile Exchange. The CME is the number one derivatives marketplace. Also, DB's securities clearing and depository subsidiary, Clearstream wants to compete with the Depository Trust and Clearing Corporation, the number one payment, clearance and settlement system for all manner of traded products. NYSE has no equivalent clearing system in the US. Already DTCC has set up subsidiaries in the UK and Europe for competing for non-US business.

In an attempt to accommodate regulators the merger partners offered to sell their single equity options and single stock futures business, the later a promising business held back by long standing regulatory disputes amongst US regulators. They offered to open DB's derivatives clearing subsidiary Eurex to others; and place a three-year cap on commissions on derivatives contracts. The merger partners contend they would offer financial market participants more transparency compared to unregulated trading venues and to "dark pools" of orders not seen in the regulated markets. They would also offer trading and clearing platforms for soon-to-be regulated Swaps and other former OTC products.

While Swaps are being designed by regulators themselves to be traded on exchanges the expectation that they will be traded primarily on existing exchanges is erroneous. Already a myriad of announced and in development "swaps execution facilities" (SEFs) are vying for market share. Who knows how many are being developed in garages ready to compete with existing exchanges. SEFs are to have real time tickers for quoting prices; and trading, clearing and settlement mechanisms like that which now exits for exchange traded stocks, futures and options. The hoped for future of Swaps trading is to allow innovation to bring greater liquidity and transparency to these markets, perhaps to demystify them so that retail product equivalents can be constructed and bring risk mitigation techniques to a broader investor population.

Swaps are just one of the next new things set to dramatically change the global financial system. New future exchanges that trade equivalents of swaps products are coming on line. Dealer traded bonds are evolving with its own set of more centralized trading, payment and clearing mechanisms; real-time risk management is now on everyone's radar screen; and electronic trading, low latency concepts and high frequency trading is under regulatory scrutiny across the globe.

Dramatic visions are also being presented by regulators. New clearing mechanisms, startups and government developed entities are emerging across all product categories. The ambitious T2S securities settlement system is being developed by the European Central Bank is to compete with private entities like Swiss based Linkup Markets and US based Depository Trust Company. The G20's newly empowered Financial Stability Board is convening global regulators to devise a global identification system for financial market participants and the products they trade, competing with the proprietary identification systems of the world suppliers of financial information and data.

This is the world that NYSE and DB want to prepare for by combining their current capabilities for the inevitable competitive world of change and innovation that is before them. What is the EC thinking when they say the combination will create a monopoly on derivatives trading in Europe? Don't they remember the "monopoly' the NYSE had in the US equity markets, or the Chicago Board of Trade had in global derivatives– long gone as these same forces that are with us today- technology innovation, customers' ever-changing appetite for new products, and globalization continue to change the winners and losers. Not too long ago the mighty NYSE bowed to these competitive forces and bought a start-up exchange, Archipelago which now dominates their suite of electronic trading systems.

This merger is not about derivatives – it's about preparing for the forces of change that has and will continue to create new players while challenging incumbents to evolve. The NYSE/DB merger is all about wise management understanding these forces and preparing for that change. The EC has still to get it!