

Regional and Transregional Exchanges in Europe

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Structure

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- I. General Determinants of Change
- II. Exchange-Specific Determinants of Change

B. Consolidation and Transregional Exchanges

- I. Euronext
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- III. Easdaq and Nasdaq Europe

C. Regional Exchanges

- I. Definition and Strategy
- II. National Exchanges
- III. Other Special-Strategy Exchanges

D. Summary

Change in the European Stock Exchange Arena

Year	Members of the European Union	Stock Exchanges
1975	9	33
2002	15	19

- Change in numbers vs. change in quality
- Avenues of change:
Government intervention (EU, national government)
vs. competition

Determinants of Change

- General Determinants

Peace, economic growth, liberalization of national and international transactions, progress in technology, concentration in banking

- Specific Determinants

European integration

- European Monetary Union
- Mutual recognition (single passport)

Electronic trading

Mutual Recognition

No ex-ante superiority of any regulator:

Carry out passported services
in all other member states
under home country regulation

Mutual recognition in Europe:

- Second Banking Directive of 1989
- Investment Services Directive of 1993, effective 1996
- Single passport

Transatlantic mutual recognition?

Global mutual recognition?

Early European Stock Exchange Competition

- 1972 Ariel: Automated Real-Time Investments Exchange Limited, London
- 1978 European Options Exchange, Amsterdam
- 1982 London International Financial Futures Exchange (LIFFE)
- 1986 Big Bang at London's "International Stock Exchange":
screen quotation system SEAQ International
- 1986 Paris introduces electronic agency auction market CAC and financial
futures market MATIF
- 1988 LIFFE introduces Bund Future
- 1988 Deutsche Terminbörse GmbH (started in 1990, automated trading)
- 1989 Competing electronic equity-trading systems in Germany (IBIS I, MATIS)

Key Developments in the Nineties

- Positioning of major forces in European exchange competition continues (Deutsche Börse 1991, Swiss Exchange 1993, ParisBourse 1997, Borsa Italiana 1997, Eurex 1998)
- Single passport levels playing field, LIFFE loses market share in Bund Future (1998) to Eurex
- Approaching cross-border consolidation for appropriate size and scope (merger concept \Rightarrow Euronext; alliance concept \Rightarrow NOREX)
- New exchange governance
- “New markets” for small and mid-sized (growth) companies

New Exchange Governance I

Demutualization thesis (market-control thesis)

- Traditional exchanges

Cooperatives providing facilities where members produce transactions themselves

- aim at low cost of facilities
- controlled by members

- Electronic exchanges

Transactions are produced by automated matching and sold to members for a fee

- maximize profits
- controlled by competition and takeover threat

New Exchange Governance II

Continued voting control thesis

- Exchange transaction services are key input for member organizations' business
- Large exchanges have market power
- Voting control required
 - to ensure that services are tailored to member needs
 - to prevent monopoly pricing
- Members have become major shareholders

What Changed

- Electronic trading enlarged the strategic arsenal of exchanges
 - Install trading screens abroad, grow for liquidity and efficiency
 - Extend services to order routing and bank office operations
 - Use systems for other markets
 - Become a system provider
- Old fashioned legal forms are impractical for mergers and participation in regular business
- New exchanges were set up as corporations, old exchanges adopted corporate form
- Major members obtained largest shares in the new corporations
 - Facilitates exchange decision making
 - Ties major players to exchanges
- Electronic trading increased exchange income

Euronext: The Transregional Exchange

Transregional exchange: Main market for stocks of more than one country (implies that exchange is catering to major financial institutions)

Euronext model for a transregional exchange

- National consolidation of spot, futures and options markets exchanges in one corporation (Belgium, France, Netherlands, Portugal)
- Creation of transregional exchange corporation (Euronext N.V. in 2000)
- National corporations merged on Euronext N.V., national shares tendered for Euronext N.V. shares (continued voting control)
- Listing of Euronext N.V. (25 percent free float)
- Joint trading, clearing and settlement systems
- National regulation accommodated by continued existence of national exchanges

Acquisition of LIFFE in 2001

Major European Exchanges

Exchange	Equity Volume Year 2001	Domestic Capitalization End of 2001	Number of Listed Domestic Companies End of 2001
London	5,074,989	2,413,272	2,438
Euronext	3,588,707	2,070,467	1,131
Deutsche Börse	1,609,878	1,203,681	749
Madrid	943,554	525,840	1,461
Borsa Italiana	791,254	592,319	288

Volume and capitalization in mio. of Euro, volume single counted.

Source: Federation of European Stock Exchanges (FESE), European Stock Exchange Statistics - December 2001, Brussels 2002.

Electronic Equity Trading Volume of Major European Exchanges in 2001

Exchange	Electronic Equity Trading Volume
Euronext	1,656,092
London	1,047,313
Deutsche Börse	959,837
Borsa Italiana	658,041
virt-x	447,931
Madrid	441,997
Stockholmsbörsen	327,770

Volume in mio. of Euro, single counted.

Source: Federation of European Stock Exchanges (FESE), European Stock Exchange Statistics - December 2001, Brussels 2002.

Other Transregionals

virt-x

- Swiss Exchange with cross-border electronic system EBS, no single passport
- Acquisition of 39 percent of Tradepoint (exchange in London), renamed virt-x plc
- virt-x runs EBS on British regulatory platform, transregional strategy
- Model for “aspiring national exchange”

Nasdaq Europe

- Easdaq gains exchange status in Belgium in 1996 ⇒ Europe responds with New Markets
- Takeover by Nasdaq Europe in 2001
- Plans to establish Nasdaq Deutschland AG with Berlin and Bremen exchanges

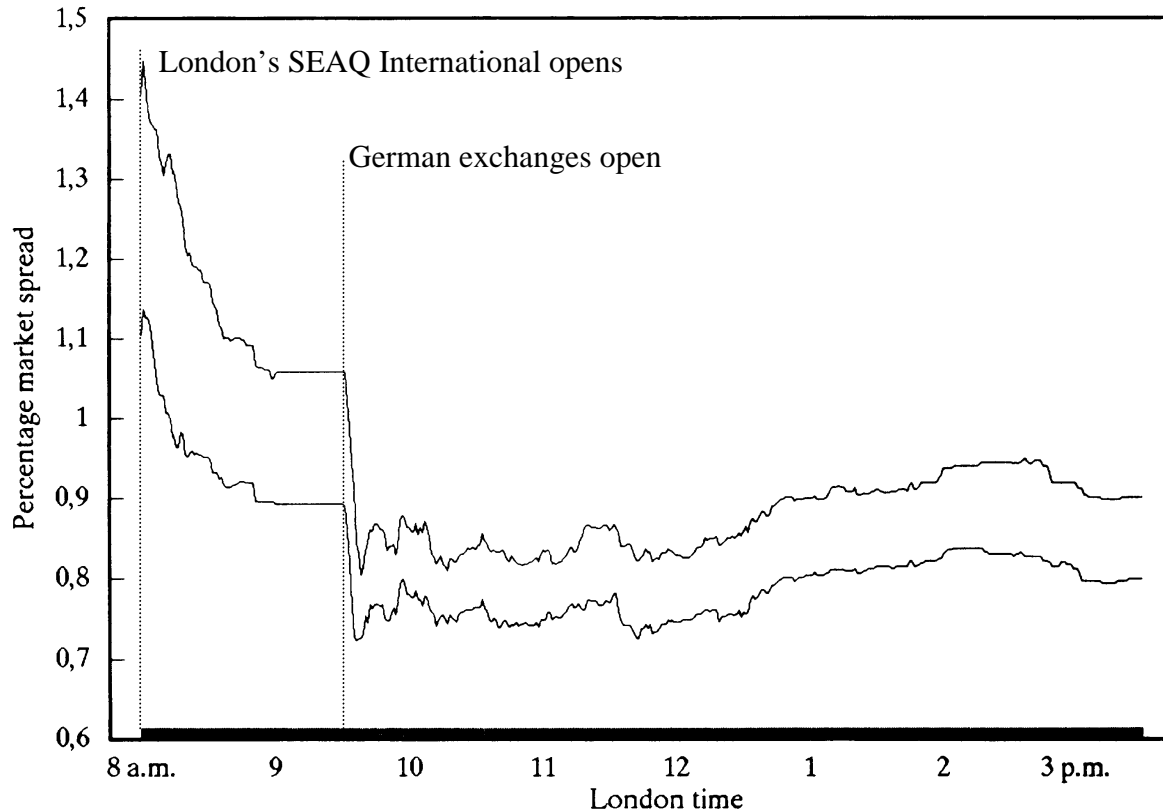
Regional Exchanges

Special-strategy exchanges

- National exchanges
 - Main market for stocks of companies located in a single country
 - Exploit valuation advantage of geographic proximity and familiarity with national language, institutions, and policy
 - Stand-alone strategy, alliance strategy (NOEX)
- Other special-strategy exchanges
 - At this point only in Germany
 - Individual-investor strategy
 - Execution inside XETRA bid-ask spread
 - One-share round lot
 - Securitized derivatives, managed mutual funds

Valuation Advantage: Intraday Market Spreads

Linde on SEAQ International, intraday pattern of market spreads for different quote sizes.



High pattern: market spread for 1000 shares
Low pattern: market spread for 500 shares

Source: Hartmut Schmidt and Peter Iversen, Automating German Equity Trading: Bid-Ask Spreads on Competing Systems, in: *Journal of Financial Services Research* (1992), p. 392.

Do We Need Regional Exchanges Tomorrow?

Transregional exchanges

- More consolidation ahead
- Major institutions prefer links to few trading systems
- Competition suffers, systemic risk increases

Regional exchanges for dynamic competition

- Aspiring national exchanges
- Special-strategy exchanges for neglected clienteles and for market improvement