Time of crisis also gives opportunities
Jeremy Grant

This month,the Frankfurt Stock Exchange launched "Borsenspiel", a competitive stock trading game aimed at attracting people who have never or only rarely traded stocks.

Virtual seed money of €50,000 will be deposited into a fictitious securities account "for speculating and investing". Participants will receive a special dictionary and be sent "supporting background articles" on investing to help them get up to speed with the art of stock market investing.

In December, when the competition ends, prizes will be handed out, including a trading internship on the floor of the exchange.

With stock markets experiencing their most stomach-churning weeks in living memory amid the unfolding global financial crisis, the timing of the Frankfurt exchange's attempt to make trading fun may not have been ideal.

According to the FTSE Mondo Visione Exchanges Index, which tracks the performance of 17 of the world's publicly listed exchanges, $16bn was wiped off the value of market capitalisation at those exchanges in September alone.

Not only has the financial crisis brought to a screeching halt years of unbroken growth at many of the world's stock and derivatives exchanges, it has cast a shadow over businesses that were once the darlings of the financial sector. Demutualisation and public listing of exchanges had helped drive record volumes on most exchanges since at least 2002, when the Chicago Mercantile Exchange became the first US futures exchange to get a stock market listing.

Herbie Skeete, managing director of Mondo Visione, which produces research on the 300-plus exchanges operating globally, says consolidation and increased deployment of sophisticated trading technology have helped exchanges perform more efficiently.

But he predicts: "Volumes in most asset classes may decline in coming months as markets react to recent changes in financial markets. This, coupled with a slowdown in the number of IPOs [initial public offerings] suggests more downside for listed exchanges, at least in the short term."

At the World Federation of Exchanges' annual meeting in Milan this month, Nasdaq OMX president Magnus Bocker said the outlook for the next year was "gloomy", predicting a fall in equity trading volume into next year.

Volatility has helped volumes, especially in the futures and options markets, which thrive on sudden changes in market expectations for the performance of underlying instruments or economic data.

US options trading has remained relatively robust, for example. Credit Suisse estimates volumes in the first half of this month at the Chicago Board Options Exchange and International Securities Exchange were up 82 per cent and 43 per cent respectively. But the value of assets traded is falling as hedge funds, some of the biggest users of exchanges, cut back on trading as their prime brokers scale back lending to them in a process of "deleveraging".

Moreover, established stock exchanges in Europe have this year been forced to deal with the rise of alternative equities trading platforms in the wake of the Markets in Financial Instruments Directive, or Mifid.

Enacted 11 months ago by the European Commission, the rule has broken the exchanges' monopolies on the trading of stocks in their host country and opened the door to competition for the first time in decades.

Using ultra-high-speed trading systems and offering cheaper tariffs than the incumbents, the new platforms - such as Chi-X, Turquoise and Nasdaq OMX Europe, backed by the US-based exchange Nasdaq OMX, have started to make inroads.

Tariff erosion is likely to continue, experts believe, as competition continues and users of exchanges focus on cost reduction and managing risk. Tabb Group, a consultancy, says: "There is no question that exchanges will lose market share to the [new platforms] and will need to fight hard to retain their commanding position, as their cost structures struggle with cumbersome legacy environments, lost revenue and pricing wars".

New issuance on exchanges has also slowed to a trickle, with IPO activity showing no sign of returning soon. While IPOs make up only a small part of an exchange's revenues, new company listings are the life-blood of a bourse's secondary market.

Consolidation has also slowed, although some acquisitions have still gone through: CME's acquisition of the New York Mercantile Exchange, and NYSE Euronext's purchase of a 25 per cent stake in the Doha Securities Market and of a 5 per cent stake in India's Multi Commodity Exchange. The MCX is owned by Financial Technologies group, an ambitious Indian trading technology company that offers a glimpse of the way the exchange business could be reshaped in Asia.

Yet as bad as the financial crisis is likely to be for exchanges, the mood is not all gloomy.

Lee Hodgkinson, chief executive of SWX Europe, the London-based Swiss blue-chip stocks platform, says the new platforms might proceed more slowly amid a "dramatic paring back of customer IT budgets, resource allocation and changed priorities".

There are the some signs that exchanges could be the beneficiaries of the fallout in other important ways.

Some of the issues at the centre of the crisis, such as lack of transparency in the pricing of certain assets and poor counterparty risk management, highlight the importance as the exchanges see it - of the kind of market infrastructure that the exchanges have long provided, such as transparent and reliable pricing, clearing and full regulation.

Deirdre Somers, chief executive of the Irish Stock Exchange, says: "In recent months, despite extraordinary market conditions, regulated exchanges have, without fail, delivered ... price formation, transparency and execution. More importantly, recent events have underscored how critical it is to have market operators who are highly vested in long-term market integrity and stability. "As economies, markets and investors respond to the changes ahead, it is time to reassert the voice of the regulated exchange as a force for re-establishing muchneeded stability and investor confidence."

Concerns over counterparty risk may also provide exchanges with opportunities. Regulators will be pushing for much of the over-the-counter trade in derivatives, foreign exchange and other asset classes to be cleared.

Fonte: Financial Times, London, October 20 2008, Exchanges & Trading, p. 1.