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## COMMENT

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# Exchange battles mask Europe's silence

The past year has redefined the landscape of exchanges around the world: consider the New York Stock Exchange and Deutsche Börse bids for Euronext; the merger between the Chicago Mercantile Exchange and the Chicago Board of Trade; the withdrawal of the Deutsche Börse offer for Euronext; the Nasdaq "final offer" for the London Stock Exchange; and the recent "Turquoise" project by seven big investment banks (four from the US) to launch a European equity platform. These should prompt stakeholders to reflect on the future of the securities and derivative markets.

The euro-bourses have failed to create a pan-European market capable of competing with the LSE and, more importantly, the US markets. Two transatlantic takeovers by US exchanges are now in motion. Why does the initiative come from the US? After all, the LSE's profits are double those of Nasdaq, Euronext's profits are two times the NYSE's and Deutsche Börse is three times more profitable than the NYSE. The reason is that stock exchange price/earnings ratios in the US are about 50 times, while the European p/e ratios are in the 20s. The contemplated transactions produce a substantial transfer of European earnings to US shareholders. Europe finances its own takeover.

It is extraordinary that neither the European Commission nor Ecofin, the committee of European finance ministers, have encouraged the European

exchanges to get together. Is it no matter to Europe that two of its largest equity markets will be owned by US stock exchanges? Would this not affect the internal market? Does the CME-CBOT merger not threaten the European derivatives market?

After Euronext's board and management hastily committed to the NYSE offer, they refused to meet Deutsche Börse. The European authorities did not raise substantial policy issues. The only proposal to do so was the excellent report by French industrialist Henri Lachmann, which was effectively rejected by both sides, even though Euronext pretended to accept it.

Where does this leave the European exchanges? Most likely with two or three competitive transatlantic partnerships: NYSE-Euronext and Nasdaq-LSE are already running. That position will be reinforced by the CME-CBOT merger which, with 88 per cent of the US derivative markets, will be the world's largest derivatives market. It will be interesting to learn the conditions put on this merger by the US Department of Justice. Will we ever know what the European Commission requested in order to approve the merger of Euronext and Deutsche Börse? Would the commission have blocked it?

There is certainly a risk of US dominance on the regulatory front. The absence of consideration for the basic rules of international private law led to regulatory overreach beyond US borders. The Sarbanes-Oxley Act of 2002

extended its jurisdiction to non-US companies. It might happen again.

It happened before. In the 1950s, America's interest-equalisation tax dried up the US foreign bond markets, which shifted from New York to London in the same way listings have been affected by SOX. The law changed, but the bond market never returned to New York. The European teams of the US investment banks years ago ceased promoting the US capital markets.

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They have used SEC Regulation S and Rule 144a to reach US institutional investors without registration with the Securities and Exchange Commission.

Will the efforts of Hank Paulson, the US Treasury secretary, convince the Congress in time to avoid a structural lack of competitiveness in the US capital markets?

The combination of these imbalances and questions requires deeper reflection. The fundamental issue is whether the mergers and acquisitions model is the right one for exchanges. The long

history of failures is not encouraging. Few questioned whether synergies announced by the various bidders could have been realised without merging the legal entities and opening a fundamentally nationalistic debate. After all, a merger is not needed in order to reduce the number of data centres and build common IT platforms. The legal structure of Euronext is a perfect example of a non-merger, called a "federative model", which realises synergies and combines markets without replacing the legal structures of its constituent parts.

Regulators have a long way to go to prepare for global markets. Euronext's college of five regulators is far from a perfect model. An incredible amount of time, energy and money has been spent in these takeover attempts. Let us pause and ask whether there is a simpler route to the globalisation of capital markets. Let us make sure that US regulators will be as open to the takeover of a US exchange by a European bidder as their European counterparts have been to the current bids.

The eurozone badly needs deeper and more fungible pools of liquidity if it wants to compete effectively with the US. That is why the silence of European authorities on what is in effect a fundamental policy issue is so loudly heard. Could this be a wake-up call?

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