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NYSE Euronext-Deutsche Börse Merger: Let the Dance Go On!

While it has often been said that trading is like dancing, exchanges have certainly been dancing with one another for some time, following the need to diversify and cope with the results of a challenging liberalisation process. The proposed merger between NYSE Euronext and Deutsche Börse would create the world's biggest exchange by revenues and total value. This needs the approval of 47 regulators across the globe, including the US Department of Justice and the European Commission. These institutions would be well advised not to try to stop the dance.

The recent wave of consolidation among exchanges has shaken the global financial community. For the first time since the beginning of the financial crisis, the industry has been able to steal the limelight from regulators. The situation is heating up at the global level, galvanising the entire sector. The market is stretching its muscles after a long rest, reshaping once again the global trading landscape with a list of new potential mergers (see Table 1). But something different seems to be driving consolidation this time. Mergers among exchanges have been rather frequent since the demutualisation in the 1990s, but this time – at least for the biggest merger proposal between NYSE Euronext (NE) and Deutsche Börse (DB) – they seem to be designed to strengthen exchanges' market power outside equities. As a matter of fact, "organised" trading platforms are steadily stretching their boundaries to achieve a more global scale and reaching into more complex asset classes, for which the provision of execution and related services is already an important source of revenues.

Exchanges now need to redesign their business models in order to keep pace with radical changes in market structure. To grow and gain business at the global level, exchanges are currently consolidating businesses to acquire relevant know-how and economies of scale in non-equity asset classes and to defend the vertical (silo) model. For instance, well before this latest wave of consolidation, Deutsche Börse (through Eurex) and NYSE Euronext (after the acquisition of the London International Financial Futures Exchange – LIFFE – in 2001) were running very profitable businesses in well-defined derivatives markets niches.

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Hence, the new process of consolidation ought to strengthen scale and expand business in non-equity financial instruments at the global level, taking stock of two general developments: 1) the liberalisation process; and 2) the financial crisis.

Firstly, the abolition of concentration rules following the implementation of the Markets in Financial Instruments Directive (MiFID), as well as the abolition of the order protection rule in the USA (with RegNMS[1]), have liberalised the provision of execution services for financial instruments by allowing newcomers to compete with incumbents under equal conditions. As a result, exchanges are striving to source enough revenues in order to maintain their current cost structures in a more competitive environment. In equity markets, more than a quarter of the entire trading turnover is currently done via new alternative trading platforms on a pan-European basis, and proposals such as a pan-European listing are gradually regaining ground. This situation is leading stock exchanges to search for greater diversification and global scale.

Secondly, in the aftermath of the financial crisis, a major regulatory overhaul is aiming to increase transparency and safety for non-equity financial instruments through greater use of organised trading platforms. Exchanges, therefore, want to be ahead of this process by investing in new infrastructures and human resources or using mergers to strengthen their role in new business areas in which they can find strong complements (see Table 2).

As a consequence of these multiple factors, exchanges will gradually become trading platforms, offering execution and post-execution services across asset classes.

1 "Regulation National Market System", Release No. 34-51808, File No. S7-10-04.

Table 1
Merger Talks in Progress

Controlling company	Target company	Date
Singapore Exchange	Australian Exchange	25 October 2010
BATS Global Trading	Chi-X Europe	22 December 2010
Micex Group	RTS Stock Exchange	1 February 2011
London Stock Exchange Group	Toronto Stock Exchange	9 February 2011
Deutsche Börse	NYSE Euronext	9 February 2011
NASDAQ OMX	InterContinentalExchange	18 February 2011*
Tokyo Stock Exchange	Osaka Securities Exchange	9 March 2011

* Not confirmed by parties (see http://www.finextra.com/news/fullstory.aspx?newsitemid=22281).

The SIX Swiss Exchange has recently upgraded its trading platform to offer execution services across asset classes (equities, derivatives, ETFs and bonds) within microseconds.[2] Stocks, in fact, are progressively becoming a small part of the core business of an exchange (also called "regulated markets" under the MiFID regime[3]). For instance, the London Stock Exchange has recently revealed its plan to extend its business to include derivatives through the creation of a pan-European platform (Turquoise derivatives) for single name and index futures and options. This announcement comes after the merger proposal with TMX, which owns the EDX derivatives platform based in Montreal.[4] This platform will most probably emerge, together with Chi-X's new platform[5], as one of the main competitors of NYSE LIFFE and Eurex in listed derivatives instruments. Finally, Deutsche Börse recently acquired control of the European Energy Exchange in Germany, which marks a further step towards greater diversification.

The Merger Case

The proposed merger between NYSE Euronext and Deutsche Börse would create the world's biggest exchange by revenues and total value (see Table 3). The result would be a group with more than €5 billion in total revenues, operating in several countries and with a total value greater than €17 billion. DB will spend €7.37 billion ($10.2 billion) to complete the takeover and merge both firms into a new holding company headquartered in the Netherlands ("Holdco").

2 FT, 16 June 2011, "Swiss bourse to offer high-speed cross-asset trading", available at http://www.ft.com/intl/cms/s/0/6bdccd42-97fb-11e0-85e9-00144feab49a.html#axzz1PnfPh9af.

3 The Markets in Financial Instruments Directive, Dir. 2004/39/EC.

4 LSE's offer for TMX is currently challenged by a competing bid made by a group of Canadian banks and pension funds (Maple). However, key TMX shareholders' recent approval of the deal with LSE may speed up the process.

5 Chi-X has recently agreed with Russell Investment to create a trading platform for stock indices and stock indices derivatives, which will compete with the most profitable business of Eurex (see http://www.ft.com/cms/s/0/2955383c-5945-11e0-b9f6-00144feab49a.html#axzz1IerUhTnl).

Table 2
Potential Synergies

	Firms	Key business synergy
SGX/ASX	Singapore Exchange	International listings, equity futures, OTC derivatives clearing
	Australian Exchange	Listings, stock options, fixed income futures
BATS/Chi-X	BATS Global Trading	Access to US markets, listings, IT
	Chi-X Europe	Pan-European trading volumes
Micex/RTS	Micex	Listings, Trading volumes, Bond markets, Currency futures
	RTS	Access to foreign investments, Futures and options markets, IT
LSE Group/TMX	LSE Group	Blue chip listings, bond trading, IT
	Toronto Stock Exchange	SMEs listings, derivatives and commodities trading
DB/NYSE Euronext	Deutsche Börse	Long-term interest rate derivatives, equity indices derivatives, clearing and settlement, access to Asia
	NYSE Euronext	Short-term interest rate derivatives, listings, equity dark trading, access to the USA
NASDAQ OMX/ICE	NASDAQ OMX	Equity trading, listings, access to the EU
	InterContinentalExchange	Clearing, derivatives trading
Tokyo SE/Osaka SE	Tokyo Stock Exchange	Equity trading, listings
	Osaka Securities Exchange	Options and futures trading

Source: Author.

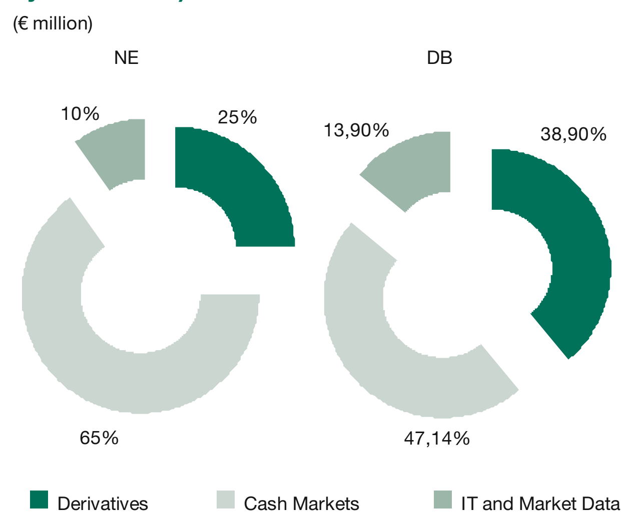
Table 3
Key Figures
(€ million)

	DB	NYSE – Euronext	Combined result
2010 Total revenue	2,106	3,306	5,412
2010 Net income	417.8	431	848.8
2010 Net revenue	-	-	4,1
2010 EBITDA[a]	-	-	2,1
Group value	10,945	6,224	-
Cost synergies	-	-	400[b]

[a] EBITDA = Earnings before interest, taxes, depreciation and amortisation; [b] Revised estimates (May 2011).

Sources: Companies' joint press release (for 2010 data) and 2010 annual reports. Exchange rate on 31 December 2010.

Figure 1
NYSE Euronext and Deutsche Börse Revenues (split by businesses)[1]
(€ million)



[1] For NE 2010 data and for DB estimation from 2010 data.

Sources: Companies' public accounts.

Both companies expect cost synergies of €400 million (recently revised upwards) through the integration of their equity and derivatives businesses for execution and post-trading services. More specifically, NE will bring its experience in short-term interest rate listed derivatives, listings (NE represents over 50% of US-EU15 domestic market capitalisation), dark equity trading (with Smartpool) and access to US markets,[6] while DB will bring in its long-term interest rate listed derivatives business, its securitised products through Eurex's platform and its strong value-added services in clearing and settlement services (silo model). As indicated by the joint press release,[7] roughly 37% of total combined revenues will come from derivatives trading and clearing, while 29% will come from cash (bond and equity) listings, trading and clearing; 20% from settlement and custody; and 14% from market data, index and IT services.

As shown in Figure 1, both groups currently generate important revenue from derivatives markets. This business area has consistently grown in the last few years. Even though it earns less revenue, DB Group has a higher value than NE due to the high profitability of its derivatives and post-trading businesses.

More specifically, DB brings to the deal Eurex and Clearstream, which are the Group's "cash cows" with high profitability ratios and total revenues that represent almost 78% of the Group's revenues. Eurex is also extending its CCP business to OTC derivatives since new regulations are pushing for greater use of central clearing services.

6 Eurex has already tried to enter the US market for futures, but in 2005 it filed an antitrust lawsuit against CME and CBOT alleging that the exchanges were impeding its entry.
7 See http://www.euronext.com/news/press_release/press_release-1731-FR.html?docid=960708.

Clearstream, on the other hand, has over €10 trillion in assets under custody and represents one of the biggest European central security depositaries (CSD) and custodian banks.

Competition Issues

On the market side, before the public offer by Holdco for NYSE Euronext shares, both NE and DB need the approval of their shareholders for the friendly merger (51% for NE and 75% for DB). To make the deal more attractive and accelerate the process, Holdco intends to distribute a special dividend of €620 million ($905 million). On the regulatory side, the merger needs the approval of 47 regulators across the globe, including the US Department of Justice and the European Commission. The deal has already been approved by some important financial authorities, such as

Table 4
Eurex and Clearstream
(€ million)

	Eurex	Clearstream
2010 Total revenues	858.7	760.7
2010 EBIT[1]	448.7	299.3
Profitability ratio[2]	52.3%	39.4%

[1] EBIT = Earnings before interest and taxes; [2] Total Revenues over EBIT.

Source: DB's 2010 annual report.

the Securities and Exchange Commission and the German Bafin. No major anticompetitive issues have emerged to push the DOJ to bring action against the deal in the USA.

At the European level, since the merger surpasses at least one of the two thresholds set in Articles 1.2 and 1.3 Reg. No. 139/2004 (or EC Merger Regulation – ECMR), the concentration is of "Community dimension". The merger, therefore, would need to be notified ex ante to the European Commission. Notification must be sent by the offeror before DB begins the public exchange offer or the public offer for NE shareholders to acquire the majority control of the NE group by Holdco. As soon as the notification is received, the Commission will need to decide (Art. 6, ECMR) whether:

- the concentration falls under the scope of the ECMR;
- the concentration is compatible with the common market;
- the concentration creates no Significant Impediment to Effective Competition (SIEC or SIC test).

Once notice of the merger has been given, the Commission will have 25 working days (Art. 10, ECMR) to reply, but the investigation period may be extended if needed, in particular if (in line with Art. 8) the Commission imposes specific conditions on the implementation of the merger. The length of the process rarely extends beyond 105 days, even if there are conditions to be applied to the merger.

In line with the EU *acquis*,[8] the Commission will perform the Significant Impediment to Effective Competition test (SIEC or SIC test), i.e. an evaluation based on dominance and the potential anticompetitive effects of the concentration. This test looks at the combined market share and dominance effect (static view)[9], but it may also assess whether the competition effects will be transitory or permanent (dynamic view).[10] As a result of this double-edged test (dynamic approach), concentrations that would create a temporary dominant position may not necessarily create a significant impediment to competition and would thus be approved. It will also be important to define the relevant market in order to assess potential competition effects. In practice, however, the Commission has frequently assessed mergers with a static approach, giving a limited role to the "efficiency defence", and by reversing the burden of proof (making it expensive) where dominance arises from conglomerate effects (or portfolio effects)[11], as in the NE-DB deal. However, the Court of First Instance's repeal of the Commission's prohibition against GE/Honeywell and the 2008 guidelines on Art. 82 of the Treaty on abuses of dominant position (now Art. 102)[12] have given a clear signal that more prominence will be given to the efficiency gains brought about by mergers.

In the merger between NE and DB, there are two main aspects that the Commission may need to take into account: 1) the joint dominant position in listing services and derivatives trading and 2) the risk of creating bottlenecks in the post-trading business.

For listing services, after the merger NE-DB will eventually hold 63% of domestic market capitalisation of the combined US and EU15 markets. Even though this position is clearly dominant, this situation does not represent a significant impediment to effective competition since listing services do not compete across these markets, although they may compete in the future. Given the high entry barriers and the absence of a pan-European listing, listing services are still national markets, and the merger does not concentrate market power and create an impediment for newcomers to enter.

For the derivatives trading business, the situation is more complicated. The Commission will need to look into the two main asset classes traded on the LIFFE and Eurex trading platforms: interest rate derivatives and equity derivatives (single names and indices). Table 5 shows that over 98% of listed derivatives on LIFFE and Eurex are equity and interest rate derivatives.

For interest rate (IR) derivatives, the merger will create a quasi-monopoly in the provision of execution services for listed IR derivatives in the EU. As suggested by Table 5, the two platforms will hold over 97% of the EU market and around 50% of the US and EU markets altogether. In practice, two big players will hold the entire business of IR listed derivatives on both sides of the Atlantic.

8 The term *acquis* refers to the whole body of EU legislation, jurisprudence and general principles of law.

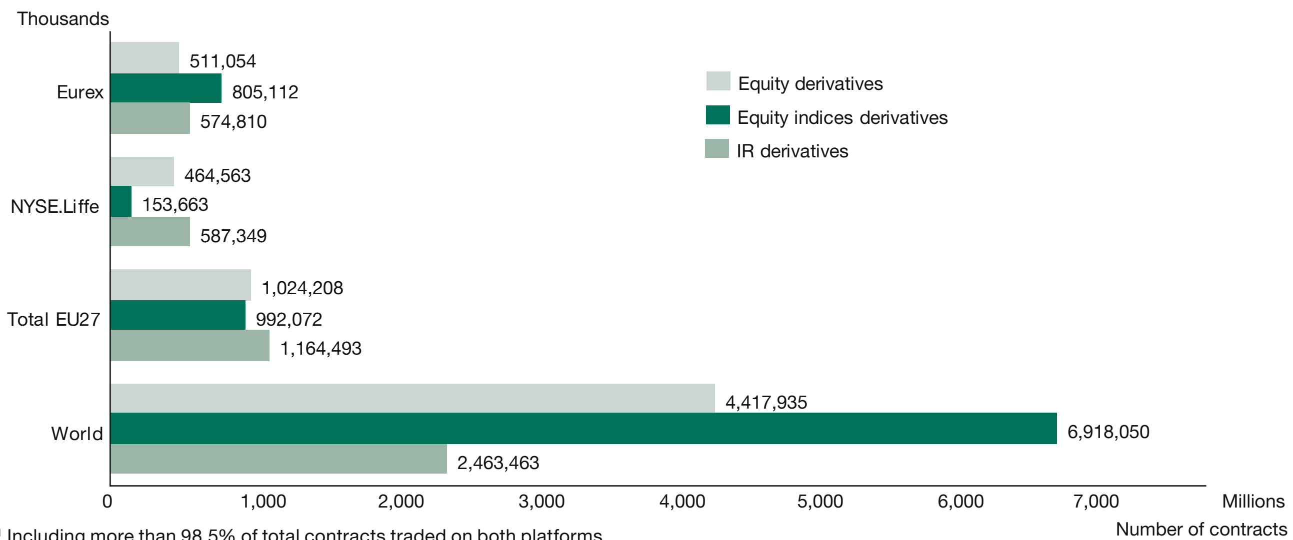
9 As in the Tetra Laval case (sentence was annulled in appeal), Case T-5/02 Tetra Laval v Commission [2002] ECR II-4381; or in the case of Airtours, Case T-342/99 Airtours v Commission [2002] ECR II-2585.

10 For instance, it may happen that a merger gives a dominant position to one market player, but this position does not impede newcomers from entering the market under equal market conditions. In this case, there is a chance that the harmful effects of concentrating market power on one player will be only temporary, while the benefits of the deal (e.g. economies of scale and scope) will generate gains for final users.

11 The merging firm has to demonstrate that efficiency effects offset potential anticompetitive effects. See Guinness/Grand Metropolitan, Case No. IV/M.938 OJ [1998] L 288/24; and General Electric/ Honeywell, Case No. COMP/M. 2220.

12 See European Commission, Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, EU COM 2009/C 45/02.

Figure 2
Main Listed Derivatives Instruments Traded[1],2010



[1] Including more than 98.5% of total contracts traded on both platforms.

Sources: WFE, LIFFE, Eurex.

However, beyond these bold numbers, there are potential defences that may also clear this part of the business from a competition policy perspective. Firstly, taking into account over-the-counter (OTC) dealers, OTC inter-dealer platforms, or other B2B OTC platforms, the "relevant market" may be considered big enough to deem the concentration harmful. However, this defence would lose strength so far as regulatory changes push OTC products towards more organised trading platforms.

As shown by Table 6, another relevant defence would be the fact that LIFFE and Eurex offer execution services in IR derivatives products that are not substitutes. In particular, LIFFE mainly offers trading for short-term IR derivatives, while Eurex does so for long-term IR derivatives.

Therefore, these products do not have any immediate substitutability and can be considered as complementary products in two separate markets. The concentration would thus not reduce competition or impede newcomers from offering execution services for similar or new IR derivatives products. As a result, the potential effects on competition would not be harmful.

The situation is slightly different, however, concerning equity derivatives and equity indices derivatives. Eurex and LIFFE are direct competitors and together hold a

Table 5
EU and US Market Shares
(listed markets; number of contracts and %)

		LIFFE	% EU markets	Eurex	% EU markets
EU market	IR Options	190,915,098	78.48	51,564,171	21.20
	IR Futures	326,744,287	43.03	414,119,160	54.54
		LIFFE + Eurex	% EU markets	CME Group	% US markets
EU and US markets	IR Options	242,479,269	99.68	223,813,168	99.84
	IR Futures	414,119,161	97.57	849,280,491	93.00
EU+US markets	IR Options	51.87		47.88	
	IR Futures	44.30		50.78	
Global markets	IR Options	45.96		42.43	
	IR Futures	21.39		43.87	

Sources: WFE and companies' websites.

Table 6
Listed IR Derivatives by Maturity

		LIFFE	% EU markets	Eurex	% EU markets
Short-term IR	Futures	301,886,363	99.87	403,243	-
	Options	190,137,814	100.00	n/a	-
Long-term IR	Futures	24,857,924	-	413,715,917	94.33
	Options	818,236	-	51,564,171	98.44

Sources: WFE and companies' websites.

high market share in the provision of trading and related services. They trade similar instruments and also benefit from close links with underlying stock markets. In addition, OTC trading of equity derivatives is a tiny part of the OTC derivatives markets. Table 7 thus shows the joint market share that the two platforms would enjoy and compares it with the EU and global markets.

As a result, the merger would increase concentration and reduce competition for listed equity derivatives in the EU. The dilemma is how the Commission will define the relevant market and whether any restrictive conditions for the provision of post-trading services will be imposed on the merging companies to soften potentially anticompetitive effects. If the Commission applies a more dynamic approach and considers that the relevant market is global, the anticompetitive effects of such a merger may be considered negligible, outside of stock futures. For stock futures, in effect, any efficiency defence may not be well-grounded, as both platforms compete on similar products and complementarity is therefore limited. The deal would certainly provide strong economies of scale, but if no competitors can challenge these volumes, the burden of a quasi-monopolistic market share may worsen market conditions and increase the costs of trading in the longer term.

However, the potential anti-competitive effects in the post-trading market architecture may overcome any efficiency defence in this area. Extending the vertical business model currently adopted by Deutsche Börse in Germany toward markets where NYSE Euronext is currently offering its services and to all derivatives trading in the EU can raise material concerns in terms of competition. Both LIFFE and Eurex offer clearing services for derivatives trading. Yet a fully vertical (including settlement services) and closed (denying access to third parties) business model may raise serious difficulties for newcomers, because it may create a bottleneck which may ultimately foreclose new entries in both trading and post-trading. The dominant position in the trading business, combined with a vertical silo model, generates long-term harmful effects. In more practical terms, on the one hand, investors (investment firms) would have a limited choice of post-trading service providers, in line with the principle introduced by Art. 34, MiFID.[13] On the other hand, potential newcomers in derivatives trading would encounter higher barriers to entry because the incumbents could raise rivals' costs by limiting access to their post-trading services. Incumbents may also indirectly force new competitors to set up their own post-trading infrastructure, since the closed business model does not allow new post-trading services providers to develop their business relying on investors' choice (Art. 34, MiFID). In this line, the UK Office of Fair Trading (OFT) already decided in 2005 to forbid the merger between the London Stock Exchange and Deutsche Börse or

13 Markets in Financial Instruments Directive, Directive 2004/39/EC.

Table 7
Listed Equity and Equity Index Derivatives, 2010

	Stock options		Single stock futures		Stock index options		Stock index futures	
	Number of contracts traded	% of total EU	Number of contracts traded	% of total EU	Number of contracts traded	% of total EU	Number of contracts traded	% of total EU
Eurex	283,339,061	51.29	150,748,431	31.96	342,919,472	81.79	407,772,104	71.19
NYSE.Liffe	194,714,042	35.24	291,272,890	61.74	57,433,095	13.70	94,268,808	16.46
Total EU	552,460,906		471,747,531		419,283,113		572,788,416	
World	3,631,919,969		786,014,934		5,036,327,425		1,881,722,248	

Sources: WFE, LIFFE and Eurex.

Euronext because of the risk that by extending the vertical silo business model or cross-shareholdings in the UK post-trade market infrastructure, the merger would have created a bottleneck and in the end increased the costs of users willing to switch trading platforms (with a substantial lessening of competition).[14] However, this national competition case was brought up before MiFID was implemented (2007) and in a period in which there was essentially no cross-border competition and the liberalisation process was still underway (2004). In addition, core activities of exchanges were only gradually opening up to more globalised financial instruments, such as derivatives and commodities. Nowadays, strong competitive pressures brought about by MiFID are reshuffling the trading landscape, and exchanges are no longer national monopolists. Newcomer trading platforms offer pan-European trading and execution in other asset classes. Therefore, in light of the recent developments and the dynamics of financial markets, the OFT position is hardly applicable to the new European framework. It is also true that other exchanges (such as the LSE with Turquoise derivatives) will most likely set up their own derivatives trading platforms, but entering a new business area is certainly more costly than taking over a monopolistic position in the market.

As a result of these competition implications, the Commission may require – as a necessary smoothing condition to approve the deal – the opening of the entire post-trading business run by Deutsche Börse, which continues to deny access to newcomers in clearing and settlement in Germany. This condition does not necessarily mean divesting the crown jewels – Eurex CCP and Clearstream – but rather forcing incumbent post-trading infrastructures to give newcomers access both to data feeds and interoperability agreements, which will be then scrutinised by national authorities and the new European supervisory authority[15] (as defined by EMIR). Once assured that the vertical closed model will not affect the dynamics of competition in derivatives trading, it will be difficult to find long-term anticompetitive effects of the NE-DB merger. Beneficial portfolio effects will most likely outweigh any harmful effects. This condition would not even come as a surprise since Deutsche Börse is already facing the threat of action on this front from the European Commission through the European Market Infrastructure Regulation regarding the requirement to provide interoperability to third parties.

14 Full text decisions are available at http.//www.oft.gov.uk.

15 The European Securities and Markets Authority (ESMA).

In conclusion, an additional issue that the Commission will have to look at is the break-off fee[16] of €250 million ($346 million) attached to the merger proposal. Even though the fee may appear low in comparison to the value of the two companies, this penalty seems high from a competition policy standpoint, since it may impede competing bids to acquire NYSE-Euronext's control. For instance, the fee that should be paid by NYSE Euronext if the deal does not go through represents more or less the total net income of NASDAQ OMX in 2010 ($395 million), which is one of the firms (with InterContinentalExchange) that has recently launched a competing bid for NYSE-Euronext shares. Therefore, the fee may seriously raise rivals' costs of a competing bid, creating "anticompetitive" effects. However, it is unlikely that the US authorities will challenge this clause under Delaware state laws, and the Commission will need to decide on this matter, too.

The Competing Deal Proposal

On March 31st, NASDAQ OMX (NO) and ICE offered $11.3 billion for NYSE Euronext, proposing to pay $42.50 per share, a 19% premium over DB's offer both in cash ($14.24) and shares (0.4069 NO shares and 0.1436 ICE shares)[17], with the $346 million break-off fee still to be discounted. The US Department of Justice, however, gave negative feedback to the merger from a US competition policy standpoint (consumer welfare). In effect, the DOJ blocked the deal on the fear that the monopolistic concentration in listing services and data products by NASDAQ and NYSE would have ultimately resulted in higher costs and worse market conditions for final users and end investors.[18]

However, it is worthwhile exploring the offer made by NO and ICE in more depth. The competing bid was not proposing a real merger so much as an acquisition, since it would have allowed the offering companies to split NE's business into two parts (derivatives and cash markets) and separately incorporate those businesses into their own. This situation could have implications in terms of both competition and market structure. On the one hand, NASDAQ OMX would have owned almost 100% of listing

16 A break-off fee is a penalty that is frequently added to merger deals to discourage competing bids on the offeree company (in this case, NE). In effect, the offeree company (NE) will have to pay to the merging company (DB) this penalty if it decides to accept the offer of the competing bidder. In any case, the cost is ultimately passed on to the offeror.

17 For more information see http://ir.nasdaq.com/releasedetail.cfm?ReleaseID=561286.

18 "The acquisition would have removed incentives for competitive pricing, high quality of service, and innovation in the listing, trading and data services these exchange operators provide to the investing public and to new and established companies that need access to U.S. stock markets.", DOJ, Press Release, 16 May 2011, available at http://www.justice.gov/opa/pr/2011/May/11-at-622.html.

services in the USA, although more competition is still to come (e.g. BATS) and the provision of execution services for equity trading will remain strongly competitive in the USA. This monopolistic position in listing services might not necessarily have been a concern for competition anyway, however, since the market for listing services is open to newcomers and does not represent a bottleneck in itself. However, US regulators typically keep the barriers to obtaining authorisation as a listing venue high and the liquidity of the incumbent trading platforms attracts new listings. In addition, the relevant market for listing services is gradually becoming a cross-border market as long as trading platforms become global players, so competition may come from other markets. However, due to the still high barriers to cross-border trading, such a concentration could have been viewed as a competition threat in the short term by US competition authorities.

On the other hand, the deal would also have had an impact on market structure and in particular on the way this acquisition would have fit into the consolidation/diversification process among exchanges (which is still in progress). The deal indeed looked somehow “uglier” than the NE-DB deal from the business side: it seemed an old-fashioned attempt to strengthen well-defined and long-standing business positions that did not necessarily open new opportunities for the market as a whole. NO would have expanded listing and data services both in Europe and the USA, creating the pan-European MTF platform it was not able to achieve with NASDAQ OMX Europe, which it shut down in 2010.

The core business would have remained equity-based, and most of the $700 million total synergies would have come primarily from cutting personnel and divesting small business units. The risk to NE of suffering another painful and costly process of integration as a result of lower margins due to more competition and the need for NO to reduce its high debt exposure in the years to come ($2.2 billion, one and a half times its total revenues for 2010) was too high. ICE, however, would have expanded its derivatives business even more in interest rates options and futures by entering the European market (through NYSE LIFFE) and competing with Eurex and new entries, such as the LSE and Chi-X. It was an interesting opportunity for LIFFE to avoid being swallowed by Eurex (likely with the DB deal) and to expand business into commodities derivatives (leveraging ICE’s capabilities).

Most interestingly, if this deal had gone through, the alternatives for the German group would certainly have been the BME Group (to extend business into bond trading and strengthen the data repository and clearing activities for derivatives) or an Asian exchange, which would have allowed DB to build up scale in the Asian market, which Eurex already entered some time ago.

Conclusions

Whether “trading is like dancing” or not, exchanges started to dance two decades ago with their demutualisation and consolidation. They now keep on dancing, following the need to diversify and cope with the results of a challenging liberalisation process started by MiFID. The recent wave of mergers comes after two years of an intense financial and economic crisis, resulting from cross-border competition, escalating first at a European level and then at a global level, especially for non-equity financial instruments such as derivatives. The fight to control the global market for listed derivatives has begun, and as long as states continue to lower economic and fiscal barriers, cross-border competition for the provision of execution services will become fiercer across asset classes and national markets. The market will continue its consolidation process until it reaches equilibrium, most probably with fewer global trading platforms, at least for most liquid products. The implications of such a process need to be assessed in a broader context, which also sees stronger consolidation for post-trading services providers. Surveillance and management of operational risks will be a crucial aspect.

The NE-DB deal will probably be a less painful process than the NYSE-Euronext merger in terms of combining businesses and realising synergies. Even though the merger comes as a defensive measure against growing competitive pressures, there is space for important cost synergies (but probably less than expected). However, besides the need to obtain political support and shareholders’ approval, there are a few competition issues to be addressed. As suggested, these concerns may be resolved by tying clear-cut conditions to the approval of the merger by the Commission. An unconditional prohibition of this deal would fail to recognise that markets are undergoing revolutionary changes, and it will just be a matter of time before we see another important merger looming over financial markets. Even worse would be a decision to elevate “national political interests” to “national market interests”, which would lead markets into an ancient dirigiste approach, the economic and political validity of which we would prefer to leave to the historians of Colbertism.[19]

19 The Australian Treasurer alleged an unclear “national interest” in the rejection of the SGX/ASX merger proposal, as recommended by the Foreign Investment Review Board (FIRB). See http.//news.yahoo.com/s/ap/20110408/ap_on_bi_ge/as_singapore_australia_stock_markets.