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The Pros and Cons of the Exchange Mergers.

Recent announcements of several potential exchange mergers have many institutional investors asking how these events could affect the industry.

The merger activity includes the sale of the TMX Group (TMX) to the London Stock Exchange (LSE), the impending merger of the New York Stock Exchange (NYSE) with the Deutsche Borse, and now the possible purchase of the Chicago Board Options Exchange (CBOE) or Nasdaq by Hong Kong Exchanges and Clearing Limited (HKEx).

The Pros:

- The most obvious advantage is the economies of scale:
 - The merger of the NYSE Euronext and Deutsche Borse will combine two of the four largest European equity trading platforms to create the world's largest exchange.
 - The LSE acquisition of TMX, which owns the Toronto Stock Exchange, Montreal Stock Exchange and other Canadian trading entities, will become the fourth largest exchange.
 - A HKEx purchase could add from \$2.6 to \$5.4 billion total market capitalization to HKEx's \$5.6 billion.
- Investors with a global strategy will benefit as exchanges continue to achieve greater share volumes that in turn, promote additional liquidity from the combined pools of additional markets.
- The large scale of consolidated trading requires less operating expenses, and subsequently, could translate to lower fees for traders and brokers:
 - More than a third of Europe's equities transactions as well as 29% of the US market would now integrate into a straight-through-processing system through the combined NYSE/ Deutsche Borse exchanges' common technology backbone.
 - In addition, clearing for the NYSE Euronext would also become more efficient as both equities and options will be brought within Eurex and their own clearing house, Eurex Clearing. Eurex is owned by Deutsche Borse and SIX Swiss Exchange. The merger would allow NYSE to encompass clearing in Europe without the risk and expense of creating their own clearing unit.
 - Access to the CME Group (Chicago Mercantile Exchange) and some regional exchanges such as India and Korea will also become available for NYSE/ Deutsche Borse exchange traders due to the cross-selling agreements with Eurex.

- US options trading will be affected more than equity trading with the NYSE/Deutsche Borse merger. NYSE operates the NYSE Amex Options and the NYSE Arca Options exchanges. Deutsche Borse operates the International Securities Exchange. It is estimated that approximately 45% of US options trading and the majority of European futures trading market volume will be consolidated into the new entity.
- The TMX/LSE merger would create \$4.1 trillion in equity trading per year and provide a major center for trading mining and energy shares.
- With the expansion of data and network centers on both sides of the Atlantic and Pacific, the merger also allows US investors the opportunity to seamlessly leverage some foreign exchange's resources, opening access to different global markets and additional worldwide liquidity.

Cons:

- Economies of scale can also reduce competition. Few independent exchanges still exist, so with reduced competition, the incentive to lower prices could decline.
- Technology instability can be a challenge with exchange mergers.
 - High frequency trading (HFT) is still very popular despite impending regulation following the May 6 Flash Crash. Many exchanges are moving to proprietary technology to meet this need.
 - Merging exchanges requires integrating the exchanges' infrastructure, a complex and lengthy undertaking. Disruptions are a possibility.
- Dark pools account for about one third of market activity. Exchanges require publicly-transparent pricing, so investors may look for liquidity alternatives to keep their trading anonymous.



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