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Trading Talk

Market Structure & Exchange Analysis

Recapping our 6th Annual Global Exchange Leader Conference

On October 1 in New York we held our 6th Annual Global Exchange Leader Conference. In this recap we will present a few key thematic takeaways and highlights from select individual sessions.

Key Takeaways

- **Every exchange in the world with a clearinghouse is focused on the OTC opportunity.** Regulatory mandates for central clearing of OTC derivatives may still be pending elsewhere in the world, but the Dodd-Frank Act mandate is live and thriving in the US. CME, for one, is starting to see some real, tangible benefit. In January of this year the company cleared \$11.6bn in interest-rate swaps daily. By September, after all three phases of the Dodd-Frank mandate were implemented, CME was clearing \$114.5bn daily. Both CME CEO Phupinder Gill and Gregor Pottmeyer, CFO of DB1, which is aiming to add €50mn to €100mn of revenues from OTC clearing by 2017, stressed this business in their remarks. LSE Group's LCH.Clearnet unit, which still dominates clearing of dealer-to-dealer interest-rate swaps, is building a buy-side offering to compete with CME. LCH still enjoys an overall market share of more than 60%, but that's down from more than 80% earlier this year. European clearinghouses, however, are still waiting for regulations there to be finalized, which may not happen until 2015, per the latest estimates. In addition to these "big three" in the rate-swap business, a slew of other exchange groups that presented at the conference — including Japan Exchange Group, SGX Singapore Exchange and Hong Kong Exchanges & Clearing — talked about opportunities to grow revenues from OTC clearing in the future.

- **M&A in the exchange space seems to be on the back burner for now.** With LSE's purchase of a controlling stake in LCH.Clearnet, HKEx's acquisition of the London Metal Exchange and the merger that created JPX closed, plus BATS Global Markets and Direct Edge having recently announced their own combination — and ICE drawing nearer to completing its acquisition of NYX — these and other players in the exchange industry appear to be focused internally rather than pursuing transformational deals. The aforementioned companies are preoccupied with integration efforts. Additionally, these companies and their smaller competitors are looking for organic growth opportunities — largely from OTC and other post-trade businesses but also from efforts to bring in business from other parts of the world without making big acquisitions — or smaller, "bolt-on" deals. CME continues to focus on launching its London-based exchange (which has suffered a string of delays), its globalization strategy and its expansion of the interest rates complex. DB1 is concerned primarily with developing its OTC and collateral management platform, as well as furthering its efforts to attract Asian market participants to its existing product suite. While we're on the subject, we believe it's important to share our thoughts regarding continued speculation about a potential tie-up between CME and DB1, which are quite simple: such a deal would be politically infeasible in Germany right now. Elsewhere on the M&A

front, NDAQ does not have the financial or physical capacity to take on another acquisition as it digests and de-levers following its purchases of eSpeed and Thomson Reuters' IR and PR businesses. Although ICE didn't present at our conference this year, owing to the pending nature of its NYX takeover, it's worth highlighting that the company on October 2 received a non-objection letter from the European College of Regulators, clearing the only remaining major regulatory hurdle standing in the way of the deal's completion.

- **Market-structure complexity doesn't adversely affect investors, but it does add operational risk that both regulators and intermediaries must strive to mitigate.** The first two sessions of the day — an address by FINRA CEO Rick Ketchum and a panel on US Equity Market Structure & Regulation featuring two exchange CEOs as well as buy-side, sell-side and ATS representatives — helped drive home this point. One key point to emerge from the panel discussion is that the evolution of US market structure (and the steady decline of institutional commission rates) has taken much of the burden of understanding and navigating market structure away from intermediaries and placed it more directly on buy-side traders. Those traders now have harder jobs and must make the necessary adjustments, but the benefits of a more democratic, efficient market structure accrue to end investors such as pension-fund beneficiaries and mutual-fund shareholders. At the same time, both regulators and industry participants must strive to ensure the safety and soundness of the system. Episodes such as the "flash crash" in May 2010, the BATS and Facebook IPOs and "Knightmare on Wall Street" in 2012 and, more recently, outages affecting the consolidated tape feeds for Nasdaq-listed stocks and US listed options all exposed gaps in the market's ability to ensure that safety and soundness. But efforts such as the SEC's Market Access Rule, the Limit-Up-Limit-Down bands for individual stocks, the SEC's proposed Regulation SCI and the current examination of SIP oversight and backup are geared toward doing just that, giving Ketchum confidence that "we're moving to an environment that, at least from a systemic risk standpoint, is a little bit more solid than where we sat a few years ago and, hopefully, even where we sat three months ago."

Other/Additional Highlights from Individual Sessions

FINRA CEO Rick Ketchum focused primarily on the various safety and soundness issues that regulators and market participants have been focused on in the wake of high-profile technology failures in recent years. Ketchum devoted much of his address on the lessons learned from the outages affecting the Tape C SIP, which disseminates market data for Nasdaq-listed stocks, in August. "It's time for all of us to step back and take a hard look [at] the interior plumbing that the us markets are dependent on," said the former Nasdaq president, head of NYSE Regulation and SEC Trading & Markets Division chief. Trading must stop as soon as any SIP communicates an outage to market participants, with any trades executed afterward cancelled, he noted further. He also supported the idea of Nasdaq and NYSE (which operates the Tape A and B SIPs) providing backup for one another's consolidated feeds, but acknowledged that the details of such an arrangement are not easy and will require careful planning to execute properly. And he responded to an audience question by rejecting the notion that competition is needed to fix the SIP, noting that intense competition hasn't prevented glitches elsewhere. Additionally, the options market needs better procedures for either re-pricing or cancelling erroneous trades. The recent episode in which a technological glitch resulted in Goldman Sachs sending a flood of erroneous options trades into the markets revealed inconsistencies among the various options exchanges regarding trade-break policies. A combination of clear policies regarding SIP-related outages, erroneous options trades and the establishment of kill switches by exchanges — along with measures already taken by regulators in recent years and months, such as Limit-Up-Limit-Down volatility protection for single stocks — should reduce the risk of systemic disruptions compared with previous years and

even earlier this year, Ketchum asserted. The CEO also offered some color on FINRA's recent rule proposal that would require ATSs to disclose, on a delayed basis through the regulator's website, trading volumes on a security-by-security basis. Firms such as Rosenblatt will continue to play an important role in analyzing dark-pool volume data, Ketchum said, but FINRA's proposal will give it the ability to calculate volumes itself, rather than relying on voluntary self-reporting by brokers. This self-reporting, of course, was endangered by Credit Suisse's move back in April to no longer disclose the volume of its CrossFinder dark ATS.

Panel – US Equity Market Structure & Regulation: This session featured a lively repartee between panelists representing exchanges, the buy side, the sell side and a major dark pool. As indicated in the first section of this recap, one key point to emerge from the discussion is that *the market-structure transformation of the past 16 years has transferred much of the burden of understanding and navigating complex rules and structural nuance from intermediaries to the investor.* The complexity we hear so much about in today's market-structure debate is not new. The NYSE rule book was anything but simple in the days of its stranglehold on trading of NYSE-listed issues, for example. But, as BIDS Trading CEO and longtime Merrill Lynch Investment Management head trader Tim Mahoney pointed out, buy-side traders years ago did not need to understand all of those rules and how to apply them. Higher commission rates, manual execution and exchanges' not-for-profit status ensured that brokers and exchanges could pay people to bear those responsibilities. Today, with the "vig" for intermediaries far skinnier and buy-side traders using electronic tools to control orders from their desktops, there is both more room for buy-side traders to add value and a greater responsibility for them to understand and navigate the structure. In effect, they've traded in high-priced travel agents for doing it themselves on Expedia, to use the analogy forwarded by a few of our panelists. Some on the buy side may strain under the weight of these new responsibilities. TIAA-CREF EVP Brandon Becker noted that traders at his organization spend more time today than in the past worrying about adverse selection, the diverse array of venues on which trades can be executed and other aspects of market mechanics — and, by definition, less time on "ideas, macro judgments and stocks." The flip side of this, according to Two Sigma Securities Executive Principal David Weisberger, is that by using Expedia one has to do more work, but also pays "40% less for his vacation in Cancun." That's the net effect of the market-structure transformation that has coincided with big declines in implementation costs for investors — "your traders have more to do, but the investor wins." Regulators and industry participants must constantly strive to ensure the integrity of the system, particularly in the face of technology failures that can be attributed in part to fragmented, for-profit venues needing to work together. "We need to strike a balance between complexity and risk," in the words of BATS Global Markets CEO Joe Ratterman. But the structure itself doesn't need a fundamental overhaul, in our panelists' judgment.

CME CEO Phupinder Gill highlighted several opportunities for CME. The biggest of these is growing interest-rate derivatives volumes. The company expects volumes to rise significantly when rates markets return to a more "normalized" environment following the expected tapering of the Federal Reserve's bond-buying activities and the accompanying rise in interest rates. CME bases this expectation in part on the fact that it has more rates products and clients today than when the rates complex hit its previous peak volumes in 2007. Bob Zagotta, Senior Managing Director of Products & Services, added that he views the rates complex as a "coiled spring." CME continues to see growth from clients outside the US, evidenced by 36% of metals volumes, 30% of FX, 23% of interest rates, 17% of Ag and 15% of energy and equity volumes coming from clients outside the US in 2Q13. The company appears committed to its incentive pricing scheme in its Brent oil contracts, which has been boosting volumes of late. And its capital-return story — chiefly the

payment of big fixed and variable dividends, funded by stable cash flows — remains intact. Gill was hopeful that the sale of the New York Mercantile Exchange building would be completed prior to year-end, which would make additional cash available this year for the company's variable, or "fifth" dividend payment. At the end of 2Q13, CME had approximately \$2bn of cash. Since then, \$750mn was used to pay down debt. The company has said it would like to keep a minimum of \$700mn on the balance sheet for day-to-day operations. Prior to cash generated from operations in 2H13, the NYMEX sale and regular dividends, CME had \$550m of excess cash on its balance sheet, or approximately \$1.65 per share.

CBOE President Ed Provost kindly presented at our conference instead of joining the rest of the company's senior management in Portugal for the CBOE's annual Risk Management Conference. Among the highlights of Provost's presentation were announcements that CBOE on October 28 will launch 24/5 trading of VIX futures, and, separately, that it has developed a new CBOE S&P 500 short-term volatility index (VXST), on which it will launch derivatives trading. VXST will measure expected 9-day volatility, whereas VIX measures expected 30-day volatility. The launch of 24/5 VIX trading is particularly exciting because of the previous delay — it was originally scheduled to commence in May, but put off following a technology glitch that halted trading for half a day. CBOE expects that its entire global customer base of VIX users will benefit from extended trading hours. VIX futures had a record 2Q13, posting ADV of 180k, the seventh consecutive quarter of sequential growth. Activity declined modestly in 3Q13 to ADV of 148k. Admittedly, we had gotten a bit accustomed to consistent sequential growth in VIX futures, so we will be interested to see if expanded trading hours can re-start the sequential growth trend. Provost also highlighted continued efforts around education and customer expansion as drivers of future growth in VIX. CBOE's S&P franchise continues to provide a solid foundation for its revenues and CBOE continues to prudently manage expenses and capital (Provost reiterated that CBOE was active in the market during 3Q in repurchasing its shares).

BVMF COO Cicero Vieira: The highlight of Vieira's remarks was an examination of the outlook for exchange competition in Brazil. Vieira laid out four scenarios under which exchange competition could occur. The first would entail a new exchange relying solely on BVMF for post-trade services. The remaining three envision an upstart developing, to varying degrees, its own post-trade assets. Scenario 1 — in which a competitor relies upon BVMF for all post-trade needs — seems the likeliest outcome. And this could not occur until at least 2015, when BVMF will have completed the consolidation of its four clearinghouses into a single CCP that would be ready to accept a competitor's transactions. By BVMF's estimates, an exchange achieving 20% market share under such a scenario could generate BRL28mn annually (\$12.7mn) in revenues, which BVMF believes is barely enough to cover expenses. The damage from such a scenario also would be limited by recent moves — particularly a shift in its fee schedule away from trading fees and toward clearing — that have resulted in just 6% of BVMF revenues coming from cash equities transaction matching. Vieira went on to enumerate a formidable list of features and capabilities a competitor would need to build to operate a suite of post-trade services that would comply with Brazilian regulations, intimating, of course, that such an outcome is unlikely.

JPX CEO Atsushi Saito provided a thorough update of where the newly merged group stands on integrating the businesses of its predecessor firms, Tokyo Stock Exchange Group and Osaka Securities Exchange. The economic policies of new Japanese Prime Minister Shinzo Abe have attracted investors to Japan and boosted volumes of late, he noted. TSE's move a few years ago to a new cash-equities trading platform, Arrowhead, also has helped support volumes, as algorithmic traders embrace the system. As part of the new group's integration efforts, all cash-equities trading moved onto TSE Arrowhead systems in July. More improvements to Arrowhead are

scheduled for 2015, including upgrades to transaction turnaround time and risk controls for erroneous orders. In March, TSE derivatives trading will move onto the OSE's J-GATE platform. Saito-san also spoke of the opportunity to grow revenues from launching new derivatives products and clearing Yen-denominated interest-rate swaps, which will soon enjoy cross-margining with Japanese Government Bond futures in JPX's clearinghouse. Cleared IRS volumes have grown steadily, reaching JPY407 tn in August 2013, up from JPY14 tn in October 2012, and the group will be introducing client clearing in the near future.

Panel — EU Market Structure & Regulation: This session proved an able and interesting companion to the early-morning discussion of US market structure. All three panelists — BATS Chi-X Europe CEO Mark Hemsley, IMC Financial Markets Managing Director Remco Lenterman and Aquis Exchange CEO Alasdair Haynes — suggested that Europe could benefit by taking a page or two out of the US market-structure playbook. Haynes cited European equity turnover being just 25% the size of the US's activity, despite the EU's GDP being comparable and its population being a bit higher, as evidence that "the structure is fundamentally wrong in Europe." One reason for this is the EU's loose approach to best execution, which allows brokers to routinely ignore superior prices on alternative execution venues and simply route all customer order flow to national listing markets such as LSE, Euronext and Deutsche Börse. "Having greater liquidity or the tightest prices isn't enough," said Hemsley. Another structural deficiency is the lack of a consolidated tape, which makes it very difficult for even those brokers who want to voluntarily route to the best prices to judge where those prices may reside. And as the process of revising the Markets in Financial Instruments Directive, which opened up national exchanges to competition for the first time in 2007, nears completion, it appears that neither of these shortcomings is going to materially change under MiFID II. There had been some talk recently of adding a "best total consideration" requirement for retail trades, which would have mandated that brokers route client orders to the best displayed prices, after taking venue fees into account, but this is, according to all the panelists, highly unlikely to make its way into the final legislation. And incumbent exchanges have done an excellent job of protecting their market-data revenues by lobbying against various efforts to establish an affordable consolidated tape. Another talked-about potential change that likely won't survive the legislative sausage making, which may come to an end by December in hopes of implementing the new directive in 2016, is open access for execution venues to clearinghouses. Allowing open access would have better enabled competition with established derivatives markets like NYX's Liffe and DB1's Euronext.

HKEx Co-Head of Global Markets Romnesh Lamba provided an update on HKEx's strategic plan. HKEx is focused on integrating and expanding LME, with a goal of leveraging the metals exchange to build China connectivity. Historically, HKEx had been an equity exchange that benefited from Chinese economic growth. In the future Lamba expects HKEx to be part of the China capital export story and has a goal to set up cooperation with all seven mainland exchanges via JVs, cross listings or strategic alliances. His goal is for HKEx to be the dominant venue in the Asia/Pacific region. Lamba also made an interesting point regarding financial transaction taxes, which have been implemented in parts of Europe and proposed on a wider basis in that region. Hong Kong currently levies a 10-basis-point stamp duty on all single shares and ETFs with Hong Kong-listed underlying securities. As a result of the stamp duty, **HFT does not exist** in those products, Lamba said, adding that regulators in Europe ought to look at Hong Kong's markets to see the impact of such a tax. Hong Kong's derivative markets lack stamp duties and have active participation from large liquidity providers.

Fireside Chat with KCG Holdings CEO Daniel Coleman: The CEO of the combined GETCO and Knight Capital Group covered a wide swath of ground, from discussing ongoing merger-

integration efforts to the new firm's major growth prospects and wider market-structure issues. Coleman said that he's striving to create a new firm, "neither GETCO nor Knight," with its own unique culture. And that culture may be derived as much by what KCG *isn't* — a bank — as much as what it is. "We look at ourselves as the leading independent securities firm in the world," said Coleman, stressing that the firm's independence from many of the related businesses banks operate will be a strength for the firm as it seeks to distinguish itself as a provider of execution services across asset classes. Of particular interest for the CEO is the firm's Bondpoint ECN, which offers matching of trades in corporate, municipal and Treasury bonds, as well as certificates of deposit. The retail-oriented platform has been gaining market share, and Coleman regards potential regulatory and market-structure changes in these fixed-income markets as a major opportunity, as divergent retail and institutional ECNs converge. It's all a marked change, of course, from the historical business of GETCO, the firm Coleman ran before the Knight merger, which made most of its money from proprietary trading in markets around the world. With access to the profitable retail equity order flow that comes with Knight's long-term client relationships, as well as the opportunity to develop the Bondpoint and related fixed-income trading businesses, KCG appears to be focused on customer businesses for future growth. The two major growth areas on which KCG will focus in the near term are expanding European execution services and fixed-income trading, particularly as banks in Europe and elsewhere grapple with how Basel III and other regulations will affect their role as traditional dealers.

NDAQ CEO Bob Greifeld provided an overview of NDAQ's strategy and diversified business segments, while also commenting on a few hot market-structure issues. Greifeld highlighted that more than 70% of NDAQ revenues are recurring in nature (though this does include some revenue streams, like US tape revenue, that depend upon overall volume and market share in transaction services), but also gain strength from the core exchange businesses. He indicated that the integration of eSpeed and the Thomson Reuters IR and PR businesses are on track, while pointing out that the opportunity for margin expansion is greatest in the Technology Solutions segment (home of the acquired Thomson units). During 2Q13, Technology Solutions had an operating margin of only 7%, compared with nearly 25% for what Greifeld called "world-class" operators in this industry. The CEO also characterized NDAQ's various other businesses that are more directly dependent upon trading volume as suffering from cyclical lows. In the meantime, increased IPO activity in the US of late — which Greifeld said is hitting levels last seen before he was CEO, during the technology boom of the late 1990s and early 2000s — is helping the Listings segment. As previously disclosed, NDAQ plans to spend \$50mn to \$60mn toward new initiatives (as part of its so-called GIFT program) in 2013, up from \$36mn in 2012. The bulk of the increase in 2013 comes from the company's NLX European interest-rate derivatives market, which launched in 2Q13. The CEO said NDAQ will give NLX "due time" to be successful, but all GIFT initiatives must show progress to justify continued investment. NLX is still in its infancy, and banks are in the process of connecting to the platform. It has targeted 10% market share (5% market share apparently would get it to break-even status), and Greifeld said NDAQ ought to know by the middle of next year if it will continue to operate the platform. We believe shutting down NLX would alleviate a large near-term drag on earnings. During the Q&A period Greifeld also addressed some market-structure issues. He opined, for instance, that brokers and exchanges are unlikely to come to an agreement on how to regulate dark and off-exchange trading. And he offered that technology failures, industry-wide, occur less now than they did five years ago, but the media pay more attention to them now. This topic came up throughout the day, and we likely will be following up with Nasdaq and other industry players to try to measure the occurrence of technology failures over the years and put them into proper context (for example, providing related data on market volatility or fragmentation that may make such failures more likely to occur).

Panel - Fixed Income Opportunities: Although certain segments of the fixed income market, such as interest-rate futures and cash US Treasuries, have been trading electronically for quite a while and swaps are moving towards trading on SEFs under new regulatory mandates, the corporate-bond market has been slower to evolve. Isaac Chang, Global Head of Fixed Income at KCG Holdings, wondered aloud why corporate bonds still trade over the phone even as we can order groceries or take-out dinners, make reservations and buy just about any consumer product known to mankind online. Several platforms, including BondPoint, MarketAxess and Goldman Sachs' GSessions, are trying to move the market toward more electronic trading. But they face big impediments — namely, a dearth of standardization, turnover and buy-side willingness to participate in price discovery process rather than simply act as price takers. Chris White, a VP in the Global Credit eBusiness group at Goldman, likened the corporate bond market, in terms of transparency and efficiency, to where the equity market was circa 1975. Consensus among our panelists was that it seems unlikely that the corporate bond market can move to a pure limit-order-book structure, but some type of hybrid between that and the current, dealer-driven model, is possible. It is clear that market participants feel something needs to be done, as dealers do not hold as much inventory today as before the financial crisis, which has led to declines in liquidity. The evolution of the market is still in its infancy and will take time to play out.

Panel — Off-Exchange Trading: Our panelists — one executive each from a US exchange, retail broker and off-exchange “wholesaler” of retail flow, as well as reps from TMX group and a major dealer in Canada, where new dark trading restrictions have been in place for about a year — seemed to agree that major modifications to the rules governing off-exchange trading aren't likely in the US anytime soon. This jibes with our long-held view, in which our conviction has grown this year, following a greater level of engagement with regulatory and legislative officials in Washington. It was interesting to hear from our Canadian panelists the effect of rules requiring “meaningful” size or price improvement (block size or one tick of improvement — or the bid-ask midpoint if the NBBO is one tick wide) there, but there are also key market-structure differences that make strict comparisons difficult. These include bans on the kind of off-exchange internalization and rebating that accompany nearly every marketable retail order in the US (accounting for 10-15% of total US volume by our estimates), as well as the existence of exchange-sanctioned internalization, through which orders can be handled with price-broker-time priority. The latter allows dealers to pair off active and passive customer trades, simulating to some extent in an exchange environment the kind of counterparty segmenting that occurs away from exchanges in the US. One interesting wrinkle in the debate occurred when NYX EVP Joe Mecane brought up an idea voiced by Citadel Investment Group Founder & CEO Ken Griffin during a fireside chat at last year's GELC — brokers who want to internalize should also be required to quote the same security at the inside in the displayed market, too. Jamil Nazarali, who runs Citadel's wholesale market maker, didn't seem to balk at that notion. It will be interesting to see if that idea gains any supporters as off-exchange trading is debated as SEC embarks on a “holistic review” of market structure. Another issue that got a lot of play on the panel was limited liability for exchanges. Although much attention is paid to the rebates retail brokers receive from off-exchange market makers in exchange for marketable customer flow, our conversations with market participants — and the remarks of this session's panelists — suggest to us that fear of having to wear big errors if exchange technology fails is just as big a reason for retail brokers avoiding exchanges whenever possible. If exchanges eventually take on full liability as part of a package of reforms that puts additional regulatory responsibilities on brokers, a trade-at rule might have more legs.

Fireside Chat with NYX CEO Duncan Niederauer: Our talk with Niederauer focused primarily on his views about how various market participants, who seemingly occupy opposite sides of a host of market-structure issues, have a duty to come together and hash out common-sense solutions to shared concerns that can subsequently be presented to regulators. Niederauer first voiced this opinion during his remarks at last year's GELC, and he expounded on them in this year's session. He asserted that today's market structure is much more difficult for investors to understand than what preceded it and that one of the key benefits of the multi-year market-structure transformation in US equities — narrower bid-ask spreads — is primarily because of the decimalization of stock prices that occurred in 2001, not the result of the string of more-recent changes including Regulation NMS. Further, we haven't done enough to proactively examine whether the massive changes of the past 16 years need reassessment or tweaking:

I've never seen any situation in any of our businesses or any of our customers' businesses where you basically adopt a set of rules or you adopt a strategy and you put them in place, and it's 10 to 15 years later, there should be an appetite to review them. ... It seems like we as an industry are just having knee-jerk reactions to when something happens – oh, let's put a Band-Aid on that. I find it odd that we as an industry seem to be unable to get together and sit down and say, 'Is this really the outcome we wanted?' We pretend it's all fine and everything is working to everyone's liking and then we only sit down and put something in place when something like the flash crash or the Knight issue happens...

When asked about whether it makes more sense for regulators and the industry to periodically review major rule changes, as part of a formal process similar to what European authorities have done with the automatic review of the 2007 Markets in Financial Instruments Directive, Niederauer responded:

I've never talked to a CEO who wouldn't periodically review his or her strategy. I'm not going to pretend that the European process is always the most fluid and desirable. None of us would say that. But I do like the fact that when they put it in, they said 'You know guys, this is a moving target. Who knows what we're going to get right? Who knows what we're going to miss? Let's at least commit to each other that no matter what happens, once a certain amount of time transpires we're just going to go back and do a review. Hopefully an intellectually honest one that says where did we hit the mark where did we miss the mark. And the places that we missed the mark, how do we tweak it and adjust it and can we build consensus around that.' I thought that was actually pretty healthy. That's never really happened in the US since decimalization and NMS, when you think about it. The only time we all sit around a table is when there's some crisis and everyone says, 'OK, now we have to rally around and figure out what to do.' None of us would run our businesses that way, just to be clear. I keep coming back to that point. Otherwise, you wouldn't have a business. If you only reacted and responded and thought about changing your strategy when a crisis happened, you wouldn't be around for many crises. You would be done.

Niederauer further offered that NYX could help lead that collective discussion, and in the past couple of years has “tried to herd the cats” at various points. Until the latest round of technology failures in August captured the attention of the press and regulators, there had been some meetings between disparate groups of market participants in which the amount of common ground was “surprising,” he said. For NYX, this includes putting on the table such controversial issues as exchange SRO status and reducing the 30-cents-per-100-shares cap on fees to access order-book liquidity. “I still think there's a way to get there,” he offered. “If everyone is willing to give to get a little bit, I think we could come out in a more rational place.” It will be very interesting to monitor

further industry deliberations on such major market-structure issues, particularly as the SEC turns its attention to conducting a “holistic review” of market structure and ICE CEO Jeff Sprecher, who has publicly criticized many aspects of that structure, becomes NYX’s new owner and leader. It’s notable, however, that NDAQ CEO Greifeld, when given the opportunity to talk about a broker-exchange accommodation during the Q&A following his remarks, gave a pretty straightforwardly dismissive response to the notion of compromise between the two groups.

Panel — Proprietary Trading Leaders Forum: Leaders of five of the world’s biggest automated proprietary trading firms discussed an array of issues facing the industry, including declining profits in US cash equities, efforts to diversify their businesses and their frustration at what they largely characterize as either misinformed or outright hostile media coverage of high-frequency trading. Virtu Financial President & COO perhaps said it best when answering a question about the firm’s recent decision to publish a paper refuting allegations by oft-quoted HFT critic Eric Hunsader of Nanex LLC that certain prop-trading firms were getting an early look at sensitive Federal Reserve economic data. Cifu noted that Virtu’s relatively simple analysis of Nanex’s allegations revealed the accusations to be based on obviously flawed market data, perhaps the ultimate irony given Nanex’s self-proclaimed expertise as an aggregator and purveyor of such data:

This was that moment in the movie Network when ‘We’re mad as hell, and we’re not going to take it anymore.’ We said, let’s put a one-pager together that shows how cockamamie this guy is. He doesn’t have the basic tools to understand the marketplace and he’s peddling this nonsense about an early release. He’s just 100% wrong. ... The problem is that the New York Post and CNBC and the Wall Street Journal and others pick this guy up as an authoritative source. And he really has and should have zero credibility. So what’s my upside? Do I go on CNBC, in one of these little boxes, and he’s going to attack me for this, that and the other thing? You know, I was probably responsible for the Kennedy assassination at the end of it, right? So we put our little thing out there and said our piece. He’s Tweeting about it 24 hours a day, God bless him, but that’s the last you’ll hear about it from Virtu. But he’s wrong. Trust me, he’s wrong.

The HFT executives, not surprisingly, argued that the market-structure transformation that has given rise to firms like theirs has brought huge benefits to end investors, primarily in the form of lower transaction costs. And they mostly agreed that the state of media coverage and market-structure criticism — in which folks who obviously lack credibility are relied upon time and again as sources in negative news stories — obligates them to do a better job of proactively explaining who they are and what they do, lest they be defined negatively by self-interested or ill-informed opponents. “When you have people out there yelling, you know, ‘these guys are the devil’ and the answer is ‘no comment,’ that doesn’t help,” said Mark Gorton, founder of Tower Research Capital. Gorton also expressed doubts, however, that even the most open and honest communication efforts would make a difference in the sometimes ill-informed criticism of HFT:

We’re living in a world in which the regulatory process can get politicized. ... We see that in Europe. There are giant structural financial problems in Europe. You can have the European officials raise their hands and say, ‘Oh my God, our currency is a giant Ponzi system and we bankrupted your entire continent. Sorry.’ Or they can say, [pointing finger] ‘Get THEM! They’re bad!’ I really think that is what has happened, to a large extent. And I think we have to be aware that we’re dealing in that environment and that we have to be thinking almost as political candidates think, where it’s not necessarily what is the truthful

answer, but how do you react in terms of news cycles and spin so that we actually engage the public in the way of other people who are talking and the politicians who are hearing it.

But Richard Gorelick, CEO of RGM Advisors, also cautioned that prop-trading firms can't simply proclaim that the status quo is acceptable, especially as many end investors, despite lower overall transaction costs in today's market structure, are frustrated at how complex and difficult to understand that structure has become:

I don't want us to get backed into the corner of always being defenders of the status quo. We didn't develop this status quo. We didn't lobby for it. We didn't ask for it. We just showed up and traded in the market as we found it. And I see plenty of opportunities to improve things. I look at Reg NMS, in particular, and see there are a lot of rules in NMS that are unnecessary for the purposes that they were originally intended for. We can do better. We can make the market simpler. We can make it more efficient and keep on the trajectory of improving market quality if we do some of these things.

Quotes of the Day

"I find it odd that we as an industry seem to be unable to get together and sit down and say, 'Is this really the outcome we wanted?' We pretend it's all fine and everything is working to everyone's liking and then we only sit down and put something in place when something like the flash crash or the Knight issue happens." — **NYX CEO Duncan Niederauer**, on the need for market participants to come together and hash out common-sense solutions to shared market-structure concerns and problems rather than simply react to crises.

"It's not free to run an exchange." — **BATS Global Markets CEO Joe Ratterman**, pushing back at the notion that aspects of Regulation NMS provide benefits to exchanges that other execution venues don't enjoy.

"Today, if you're trading and you're trying to trade by hand and pushing your own button for 5,000 shares at a clip? Guess what, you're ... committing malpractice." — **David Weisberger, Executive Principal, Two Sigma Securities**, comparing point-and-click trading to a pilot that refuses to use modern electronic navigation tools because he'd rather rely on his years of flying experience (this came with the only pilot-over-the-PA impersonation we've seen in our six years putting on GELC, which was easily one of the day's funniest moments).

"You break it, you own it." — **BIDS Trading CEO Tim Mahoney**, describing how the SEC first encouraged competition among market centers in 1975, with amendments to US securities laws, and has a responsibility to continue to monitor and tweak market structure as it evolves.

"We would probably be interested in trade-at on some kind of pilot basis." — **TIAA-CREF EVP Brandon Becker**, on the giant pension fund's interest in the SEC experimenting with rules that would require off-exchange trades to achieve a meaningfully better price or size than available on exchanges.

"The structure is fundamentally wrong in Europe." — **Aequis Exchange CEO Alasdair Haynes**, on how deficiencies in European market structure, including loose best-execution rules and the lack of a consolidated tape, result in less liquid, less efficient markets for end investors.

"You can have the European officials raise their hands and say, 'Oh my God, our currency is a giant Ponzi system and we bankrupted your entire continent. Sorry.' Or they can say, [pointing finger] 'Get THEM! They're bad!'" — **Tower Research Capital Founder Mark Gorton**, on how the politicization of market-structure regulation results in HFT firms being demonized in Europe.

"I think eventually probably, basically every security on the planet will be electronic in some form as computer modeling gets more sophisticated." — **Gorton**, discussing how corporate bonds and other instruments that are still traded in large part through manual means and traditional dealers will eventually fall under the influence of automated trading firms.

"The problem is that the New York Post and CNBC and the Wall Street Journal and others pick this guy up as an authoritative source. And he really has and should have zero credibility." — **Virtu Financial President Doug Cifu**, expressing frustration that major media outlets turn again and again to critics such as Nanex LLC's Eric Hunsader despite clear evidence of their lack of expertise.

"I have a Schwab account. I've had it since I've been in college. When I go place a trade I push a button I get a fill. It's less than ten bucks. Everything's fine. When I come back a year later the market's 20% higher. How is that rigged against me?" — **Tradebot Systems Chairman Dave Cummings**, wondering aloud why allegations continue to fly in the media and among market-structure critics about retail investors getting a bum deal from modern market structure.

"We can do better." — **RGM Advisors CEO Richard Gorelick**, urging fellow HFT leaders to not be content with the status quo, especially as many end investors express frustration with how complex and difficult to understand market structure has become.

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