

Nanyang Business School, NTU

BC3402: Financial Service Processes and Analytics

Tutorial 7: Financial Networks (I & II): Financial Networks

Question 1:

CLS Group was founded in 1997 to create the first **global settlement system, eliminating settlement risk in the foreign exchange market**. CLS Settlement is the market standard for FX settlement and is the industry's response to increased and continuing regulatory concern about settlement and systemic risk associated with the growth in FX trading.

CLS Settlement is offered by CLS Bank International ('CLS Bank'). CLS Bank operates the largest multi-currency cash settlement system to eliminate settlement risk in the foreign exchange market.

Based on information in the settlement service and recent central bank and market surveys, CLS estimates that in terms of the market for which it provides settlement risk elimination services, its **market share is 68%** as at April 2010. This emphasizes how successful the service has become since its launch 2002. **Seventeen currencies are currently eligible for CLS Settlement.** They are: US Dollar, Euro, UK Pound, Japanese Yen, Swiss Franc, Canadian Dollar, Australian Dollar, Swedish Krona, Danish Krone, Norwegian Krone, the Singapore Dollar, the Hong Kong Dollar, the New Zealand Dollar, the Korean Won, the South African Rand, the Israeli Shekel and the Mexican Peso.

More details of CLS Group can be found at <http://www.cls-group.com>.

- a) Describe some of the functions and services provided by the CLS Group.
- b) Are the local Singapore banks (DBS, UOB, OCBC) members of CLS Group? What are some of the advantages of joining this Group?
- c) Briefly describe the operations involved in the settlement of foreign exchange in CLS Group.

Question 2

Read the following article and answer the questions below.

London Stock Exchange's Bid for TMX May Help Alpha, Schmitt Says

London Stock Exchange Group Plc's bid for TMX Group Inc. may advance efforts by Alpha Trading Systems to become a full exchange with a listings business in Canada, said Jos Schmitt, chief executive officer of the bank- owned trading platform.

LSE agreed Feb. 9 to buy TMX Group, owner of the Toronto Stock Exchange, for about C\$3.2 billion (\$3.24 billion) in stock. LSE shareholders will own 55% of the combined company, while TMX investors will own the rest.

“The entire merger is an element that should be favorable to our recognition as an exchange,” Schmitt, 48, said in an interview. “We become the major Canadian anchored marketplace.”

Alpha, an alternative trading system (ATS) owned by Canada’s biggest banks, said it applied to regulators about 10 months ago to become an exchange to challenge TMX’s Toronto Stock Exchange and TSX Venture Exchange.

Alpha trades TMX-listed stocks on its platform, yet doesn’t have regulatory approval to assign companies a listing on its own system. Schmitt says he expects Alpha to have approval this year as part of its exchange application to the Ontario Securities Commission.

“I hope this will help accelerate the regulatory process around the recognition of Alpha as an exchange,” Schmitt said. “We absolutely need to make sure we bring competition in the listings space.”

National Bank Financial analyst Shubha Khan said he questions whether Alpha can gain more listings against a larger, trans-Atlantic rival.

“I don’t think you’ll see a big migration of listings from the TSX to Alpha or a whole bunch of new listings going to Alpha,” Khan said. “I’d argue it would be more attractive to list on a merged TMX-LSE rather than Alpha. You’d have access to a broader capital market.”

A sale of TMX to the London exchange would be the largest foreign takeover of a financial services company in Canada, where banks and insurers are protected by ownership limits.

The transaction requires approval of Ontario and Quebec securities regulators as well as Canada’s federal government, and needs support of two-thirds of TMX shareholders.

“What struck me is they’re not packaging this merger as a defensive move to thwart” competition, Khan said.

Alternative marketplaces have eroded TMX’s former monopoly in stock trading in the past three years. Alpha, which started in November 2008, had about 19 percent of the share of Canada’s stock trading marketplace last year compared with about 73 percent by TMX, according to the Investment Industry Regulatory Organization of Canada. Other platforms and exchanges in Canada, including Instinet’s Chi-X, Canadian National Stock Exchange and Pure Trading, had about 8 percent of the market.

Source: Bloomberg 2011

- a) The rapid development of alternative trading systems (ATS) across the world has significantly impacted the market share of traditional stock exchanges. What do you think are the three (3) main factors that help to fuel this growth of ATS?
- b) Given the significant promise of ATS as evidenced by its rapid success in increasing market share, why do you think Alpha wants to become an exchange?
- c) One purpose of a trade execution venue is to determine the underlying price of the trading security (i.e. price discovery). How does an ATS determine the executed price of a particular security?
- d) In recent years, various stock exchanges have experienced immense competition from alternative trading systems (ATS) across the world. What are some ways information technology can help re-invent the original business model of an exchange to increase its profits?