ARTICLE REPRINT

Stay Tuned . . . to the Exchanges

by Hank Boerner

June 2005

INVESTOR RELATIONS

update

PUBLISHER
Louis M. Thompson, Jr.

EDITOR
Laura Bernstein

PRODUCTION MANAGER
Melissa Jones

CONTRIBUTING EDITOR
Carol Metzker

DIRECTORS
Mary Dunbar, *Chairman*

Donald Allen
Brian Arsenault
Blair Christie
Paul Gifford
Karen Gross
Margo Happer
Tom Katzenmeyer
Catherine Mathis
Pamela M. Murphy
Randi Paikoff Feigin
James R. Ryan
Matthew Stroud
Bina Thompson
Louis M. Thompson, Jr
Lynn A. Tyson
Maureen T. Wolff-Reid
CIRI Representative
John Rogers

IR Update is published monthly by the National Investor Relations Institute as a service to its members. Annual subscriptions are available to nonmembers: $175. ISSN 1098-5220 © 2005 by the National Investor Relations Institute. All rights reserved. Reprint permission granted by the National Investor Relations Institute.

FOR SUBSCRIPTIONS OR CHANGE OF ADDRESS, CONTACT: NIRI–*IR Update*, 8020 Towers Crescent Drive, Suite 250, Vienna, VA 22182, Phone: (703) 506-3570, FAX: (703) 506-3571, e-mail: amumeka@niri.org

IR UPDATE E-SUBCRIPTIONS FOR NONMEMBERS:
Annual subscription: $75.

PLEASE SEND QUERIES OR SUBMISSIONS TO:
Laura Bernstein, Editor, Phone: (540) 955-3696,
e-mail: irupdate@niri.org

ADVERTISING AND REPRINTS:
Melissa S. Jones, Production Manager, Phone: (703) 404-2065
FAX: (703) 404-2066, e-mail: missy3578@aol.com

REPRINT FEES PER ARTICLE:
Electronic copy — Adobe Acrobat PDF file
Authors only: $75, Members: $200, Nonmembers: $300
Web posting or e-mail distribution: $500

Hard copies: Quantity under 10: $10/copy
Quantities 10-100: $5/copy
An estimate will be provided for quantities over 100.
All prices are subject to a signed agreement.

NIRI WEB SITE: www.niri.org

Stay Tuned … to the Exchanges

By Hank Boerner

You can always count on Wall Street for surprises — and the latest proposal is a stunner. First, some background on the major player in this unfolding drama.

As the new government of the United States of America was taking shape in its first capital, New York City, 24 merchants gathered under a nearby buttonwood tree on Wall Street, close to Federal Hall, the seat of government. They were there in May 1792 to strike an agreement to "trade" the bonds being issued by the new nation.

The group under the tree started the ball rolling toward a formal securities exchange with merchant bankers and brokers representing buyers and sellers; the powerful New York Stock Exchange would evolve from these modest beginnings.

It was also the beginning of the human "open outcry" method of matching bids and offers, a long tradition still used today on the NYSE floor. Fast-forward to the 20th century and the introduction of electronic executions of trades: The arguments have raged over whether electronic or human systems give the investor the better deal on prices for issues for three decades. The debate may finally be settled in favor of e-trades.

The NYSE was long a membership-owned entity; nicknamed "the Club" for its well-known, exclusive atmosphere and mostly closed ways of doing business, the exchange over the decades became an efficient auction market, with a floor trader holding forth at his trading post and having other traders come to one designated spot to buy and sell bonds and, later, shares of stock of chartered corporations. In time the traders became known as "specialists" because they specialized in the issues of only a limited number of corporations. Today there are 1,366 "seats" or members (individuals, partnerships and corporations) that own the NYSE.

Where once an individual literally bought a seat (conferring trading privileges), today seven large companies own roughly 700 of the seats, and many others are "owned" by specialists but in fact financed and considered to be owned by their employers, including Merrill Lynch and Morgan Stanley.

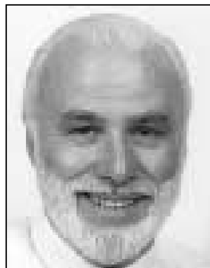
Over the years, other stock exchanges emerged — the American Stock Exchange, starting life on Broad Street as the "Curb Exchange," with traders and runners in the street and yelling bids and offers out of windows! The American moved to its own floor, and another trading mechanism emerged — a non-technology system operated by the National Association of Securities Dealers, known today as NASD. The member-brokers used old-fashioned printed fliers for quoting prices to buyers and sellers, and individual NASD members made markets in specific issues. (Unlike the NYSE, numerous traders could make a market in a stock.)

In the early 1970s, the NASD invested significant sums in technology to create the Nasdaq Exchange, "AQ" meaning "automated quotation" — quaint by today's standards, but revolutionary three decades ago.

Today, thanks to technology, trillions of dollars of debt and equity issues are traded each year on the NYSE; more than 3,000 companies have chosen the exchange to list their issues for trade. As trading volume increased, the NYSE invested heavily in technology to become more efficient and exceedingly faster, moving from paper to electronic digits in the special-

ists' books to match buy and sell orders. By 1999, a "virtual reality" system was being installed, a 3-D trading floor to match the complexity of global trading.

The technology revolution of 1975-2005 created opportunities but also difficult moments for the NYSE. Numerous upstart "electronic communication networks" (ECNs) emerged over the last decade, and the price of a seat on the NYSE fell below $1 million in 2005.



Hank Boerner

Then in April came a startling announcement: the venerable gray lady of Wall Street would merge with a brash upstart to create a major new exchange, part physical (at 11 Wall Street) and part cyberspace!

The New York Stock Exchange intends to merge with Archipelago Holdings, a nine-year-old public company, in a trade of public shares for member seats. The NYSE membership-based not-for-profit entity would "reverse merge" into a publicly traded company. The bid for a seat quickly rose to $2.5 million; one insider told this writer that many seat owners would likely welcome the opportunity to cash in "membership" for liquid stock and greater upside potential in the publicly traded Archipelago.

So what is in all this for IROs? Some issues to Stay Tuned to:

- Investors feel a certain loyalty to the NYSE; its brand name has great cache and for some is considered the global gold standard in stock trading.

- The regulatory function of the NYSE (as a federally chartered self-regulatory organization) now must be determined. (The NYSE regulates brokers-members and governance and other aspects of listed companies.) A new entity could emerge, further complicating life for listed companies in the post-Sarbanes-Oxley environment. Nasdaq has separated its trading and regulatory functions.

- Institutions will be most affected by the changes, says Wharton University finance professor Jeremy Siegel; buy-side managers want cheaper, faster and more efficient trades at greater speeds. The price spread, he added, will only matter to big-volume traders.

- Perhaps most important to IROs is that falling prices — i.e., to 1 cent per share — will eliminate the 3- to 5-cent-per-share cushion that today pays for much of the financial analysis and research (on a 5-cent trading cost). This was a much discussed topic at the recent Investorside Research Association meeting in New York City; who will pay for research is the elephant in the room, and the NYSE-Archipelago proposal could spell disaster for stock research as we have known it. Dozens of companies have lost coverage in recent months.

- Me-too moves could change the face of trading even further; on the heels of the NYSE announcement, Nasdaq announced it would buy Archipelago competitor Instinet for almost $2 billion. Together, the two deals could consolidate power, but what will be the effect on corporations and investors? Listing prices and related costs could be increased to cover smaller margins on trades. (There could concentration of pricing power in just two major exchanges, or more spirited competition.)

- "Stocks and bonds" were staple offerings of the NYSE for decades; in recent years, a smorgasbord of alternative offerings were served up to investors. The two major surviving exchanges will be well-equipped to offer a dazzling array of debt, equity and hybrid products to global investors. The corporate choice of how to go to market — using debt, equity, derivatives, public or private money, etc. — could change in dramatic ways in the coming months, especially as the surviving exchanges create competitive products.

There is still much dust to settle on these deals, and much for the IRO to stay tuned to. Perhaps the most hoped-for outcome for corporations that list on these exchanges is that investors are attracted to "the best deal possible" and continue to march to markets bidding for their business. IRU

Hank Boerner, IR Update's *corporate governance commentator, is managing director-NY for Rowan & Blewitt, a management consulting company. He formerly was an officer and head of communications for the New York Stock Exchange. The views presented are his own. Boerner welcomes e-mails at: hank@hankboerner.com.*